OAH 8-2500-21026-2
PUC G-002/GR-09-1153

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE PUBLIC UTILITIES COMMISSION

In the Matter of the Application of Northern States Power Company, a Minnesota Corporation, for Authority to Increase Rates For Natural Gas Service in Minnesota	**SUMMARY OF TESTIMONY AT THE PUBLIC HEARINGS, FINDINGS OF FACT, CONCLUSIONS AND RECOMMENDATIONS**

This matter came on for hearing before Administrative Law Judge Eric L. Lipman on June 21, 22 and 24, 2010 and on August 9, 2010 in the offices of the Minnesota Public Utilities Commission (Commission), 350 Metro Square Building, 121 Seventh Place East, St. Paul, Minnesota.

Pursuant to the Second Pre-Hearing Order, the parties submitted post-hearing submissions on July 27, 2010 and August 19, 2010. Further, following the receipt of the Applicants' September 13, 2010 submission on its actual interest coupon rates for long term debt, the hearing record closed.

Christopher B. Clark, Managing Attorney and Matthew P. Loftus, Senior Attorney, Xcel Energy, 414 Nicollet Mall, 5th Floor, Minneapolis, MN 55401; Michael J. Bradley, Richard Johnson and Valerie Means, Attorneys at Law, Moss & Barnett, 90 South Seventh Street, 4800 Wells Fargo Center, Minneapolis, MN 55402, appeared on behalf of Xcel Energy (Xcel or the Applicant).

Karen Finstad Hammel and Julia E. Anderson, Assistant Attorneys General, 445 Minnesota Street, Suite 1400, St. Paul, MN 55101, appeared on behalf of the Minnesota Department of Commerce, Office of Energy Security (OES).

William T. Stamets, Assistant Attorney General, 445 Minnesota Street, Suite 900, St. Paul, MN 55101, appeared on behalf of the Office of Attorney General, Residential and Small Business Utility Division (OAG).

James M. Strommen, Attorney at Law, Kennedy & Graven, 200 South Sixth Street, 470 U.S. Bank Plaza, Minneapolis, MN 55402, appeared on behalf of the Suburban Rate Authority.

Jerry Dasinger, Christopher Fittipaldi, Stuart Mitchell and Michelle Rebholz appeared on behalf of the Commission.

STATEMENT OF ISSUES

1. Is the test year revenue increase sought by Xcel reasonable or will it result in unreasonable and excessive earnings by Xcel?

2. Is the rate design proposed by Xcel reasonable?

3. Are Xcel's proposed capital structure, cost of capital, and return on equity reasonable?

FINDINGS OF FACT

I. PROCEDURAL BACKGROUND

1. Xcel is a natural gas utility that serves approximately 430,300 customers in Minnesota, ninety-two percent of which are residential customers.[1]

2. On November 12, 2009, Xcel filed a general rate case seeking an annual rate increase of $16,220,000. Based on a test year ending December 31, 2010, the requested increase represents a 2.8 percent increase in retail revenues.[2]

3. On November 13, 2009, the Commission issued a notice requesting comments as to whether the Commission should accept the filing as substantially complete and whether it should refer the matter to the Office of Administrative Hearings (OAH) for contested case proceedings.[3]

4. The OES and two large retail customers of Xcel, Gerdau Ameristeel Corporation and Marathon Petroleum, recommended referral of the matter to the OAH as a contested case.[4]

5. On January 7, 2010, the Commission issued an *Order Accepting Filing and Suspending Rates*, a *Notice and Order for Hearing,* (referring the matter to the OAH for contested case proceedings) and an *Order Setting Interim Rates*. The Commission's Order for Hearing referred the issues referenced above for the contested-case hearing.[5]

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[1] Xcel Ex. 7 (Poferl Direct).

[2] Xcel Ex. 1 at 3 (Application, Volume 1).

[3] *See,* E-Docket No. 200911-44028-01.

[4] *See,* E-Docket Nos. 200911-44327-01 and 200911-44369-01.

[5] *See,* E-Docket Nos. 20101-45764-01 and 20101-45766-01.

6. The Commission's interim-rate Order authorized an annualized interim rate increase of $11,076,000 – an amount that represented a 1.91 percent increase in retail revenues.[6]

7. Administrative Law Judge Eric L. Lipman held a prehearing conference on January 22, 2010.[7]

8. By way of a Second Prehearing Order issued on February 8, 2010, the petitions for intervention filed by Suburban Rate Authority (SRA), Energy CENTS Coalition (ECC) and the Residential and Small Business Division of the Office of Attorney General (OAG) were granted.[8]

9. Additionally, on February 8, 2010, the Administrative Law Judge issued a Protective Order restricting the use, handling and disclosure of confidential information.[9]

10. Four public hearings were held in this matter and a series of written comments on the proposed increases were received during and after the public hearings. The public hearings were conducted on:

- Saint Paul – April 26, 2010 at 7:00 p.m.
- Saint Paul – April 27, 2010 at 1:30 p.m.
- Woodbury – April 27, 2010 at 7:00 p.m.
- Saint Cloud – April 29, 2010 at 7:00 p.m.[10]

11. Over the course of the four public hearings in this matter, five members of the public offered testimony. Each objected to any increase in natural gas rates.[11]

12. Before the close of the comment period on Friday, May 7, 2010, 29 members of the public submitted written comments. Each objected to any increase in natural gas rates.[12]

13. Emblematic of the type of comments received from the public were the concerns of Debra Thul, of West Saint Paul, Minnesota, as to the timing of the proposed increases. Ms. Thul observed: "I do not believe that [Xcel] need[s] another increase in

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[6] *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Natural Gas Service in Minnesota*, Docket No. G-002/GR-09-1153, at 1 (January 7, 2010) (E-Docket No. 20101-45765-01).

[7] *See,* E-Docket No. 20103-47699-01.

[8] *See,* E-Docket No. 20102-46855-01.

[9] *See,* E-Docket No. 20102-46856-01.

[10] *See,* E-Docket Nos. 20107-52268-01, 20107-52268-02, 20107-52268-03 and 20107-52268-04.

[11] *See, e.g.,* April 27, 2010 Public Hearing Transcript, at 20 and 27-28; April 29, 2010 Public Hearing Transcript, at 14 and 17.

[12] *See,* E-Docket No. 20104-49832-01.

energy charges, especially now, while people are losing their homes, jobs, and while Xcel executives are flying around on their corporate jet."[13]

14. Likewise, some members of the public questioned whether increasing residential rates were consistent with the state's conservation goals. As Chris Sahr, of Roseville, Minnesota, urged:

> I am not at all totally opposed to rate increases but for residential customers this rate increase is regressive and punishes people who are taking steps to use less energy. This rate change is not in the public's best interest.
>
> It appears that this rate change will hit small residential customer harder than large residential users. Many of those small users are elderly or just people trying to save a dollar by keeping their use low.
>
> The rate also minimizes the benefit of upgrading a home so that it burns less gas.
>
> To be sure, the rate increase is minimal. I personally used 160 therms of gas last month and so my bill will only be increased a few dollars. But why put in place a rate change that has an effect that is negative on all accounts. It would be better to increase the rate on heavy users which would encourage them to use less.[14]

15. An evidentiary hearing was held in this matter and sworn testimony was received on June 21, 22 and 24, 2010, and August 9, 2010.[15]

16. On July 21, 2010, Xcel moved to include into the hearing record late-filed Exhibit 96. Exhibit 96 included the Applicant's response to an information request from Commission Staff as to Relocation Capital Expenditures.[16]

17. The SRA opposed receipt of the late-filed exhibit into the record.[17]

18. Following a telephone conference call, the Administrative Law Judge set an additional evidentiary hearing date for the limited purpose of receiving testimony as to the claims and contentions found in Xcel's proposed Exhibit 96.[18]

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[13] *See,* E-Docket No. 20104-48840-01.

[14] *See,* E-Docket No. 20102-47097-01.

[15] *See,* E-Docket Nos. 20107-52268-05, 20107-52268-06, 20107-52268-07 and 20109-54147-01.

[16] Xcel Ex. 96.

[17] *See,* E-Docket No. 20107-52841-01.

[18] *See,* E-Docket No. 20108-53148-01.

19. On July 27, 2010, initial post-trial briefs were filed by the Applicant, OES, OAG and the SRA.[19]

20. On August 9, 2010, representatives of Xcel, SRA and OAG participated in the reconvened evidentiary hearing. In addition to receipt of direct testimony and cross-examination of Xcel witness Mr. William Kaphing, written and oral testimony was received from SRA witnesses Mr. John Maczko and Ms. Melissa Manderscheid.[20]

21. On August 19, 2010, the parties filed reply briefs.[21]

22. During the course of the proceeding, the parties resolved a significant number of issues. As a result, the Company now requests a rate increase of $9.924 million or 1.71 percent.[22]

23. On September 13, 2010, Xcel submitted into the record the actual interest coupon rates for the $500 million of long term debt issued by the Company during August of 2010. This debt was issued at rates which are lower than the coupon rates reflected in the record and had the effect of reducing the revenue requirement in this proceeding.[23]

II. DISPUTED ISSUES.

24. At the time Xcel filed its July 9, 2010 letter identifying resolved and unresolved issues, the following operating income and expense issues were specifically contested:

A. Bad-debt Expenses;
B. Rate Case Expense Amortization;
C. Xcel Energy Foundation Expenses;
D. Medicare Part D;
E. Residential Customer Charge;
F. Return on Equity;
G. Cost of Debt and Capital Structure;
H. Employee Compensation;
I. Sales Forecast (Interruptible Class);
J. Small Commercial Customer Charge; and
K. Relocation Capital Expenditures.[24]

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[19] *See,* E-Docket No. 20109-54147-01.

[20] *See,* Ex. 96; Ex. 97 (Xcel's response to SRA discovery); Ex. 98 (Additional Surrebuttal of John Maczko; Ex. 99 (Additional Surrebuttal of Melissa Manderscheid).

[21] *See,* E-Docket Nos. 20108-53646-01, 20108-53646-02, 20108-53646-03, 20108-53662-01, 20108-53663-01, 20108-53663-03, 20108-53663-02 and 20108-53671-01.

[22] Xcel Reply Brief, at 64.

[23] *See,* E-Docket No. 20109-54372-01.

[24] *See,* Xcel Letter as to Disputed and Undisputed Issues (July 9, 2010) (E-Docket No. 20107-52448-01).

A. Bad-Debt Expenses.

25. Xcel's proposed test year includes $4,303,053 in bad-debt expense.[25]

26. Under Xcel's accounting procedure it writes off the oldest delinquent bills first and does not separately track whether the late payments or bed debt arose as a result of the customer's consumption of natural gas or electricity. Instead, Xcel views any unpaid balances as a bad debt of the company – and later assigns back to separate gas and electric utilities a share of the company-wide bad debt.[26]

27. OES asserts that the amount of bad-debt expense in the test year should be more closely related to the historical averages of bad-debt expense to the sales revenue Xcel has received for natural gas service. On average, over the past three years, bad-debt expense represents a 0.74 percent share of Xcel's natural gas sales within Minnesota. OES asserts that bad-debt expense should likewise represent a 0.74 percent share of Xcel's natural gas sales in Minnesota during the test year.[27]

28. Applying OES' recommended average ratio of bad-debt expense – of 0.74 percent – to Xcel's test-year retail revenue of $571,204,141, equals $4,200,879. There is a difference of $102,174 between the amount of bad-debt expense urged by Xcel and the amount urged by OES.[28]

29. The OAG urges the Commission to carry forward a ratio of revenue to bad debt expense from Xcel's last rate case – 0.356 percent – on the grounds that that natural gas commodity revenue is lower today than in recent years and approximates the commodity revenue levels during Xcel's last natural gas rate case.[29]

30. Among the three competing approaches, OES's recommends the best method of calculating this expense. OES's method directly links the bad-debt expense with Xcel Gas-Minnesota revenue data in recent years; shields the calculation from impacts in other areas of the utility's operations; is consistent with the approach that Xcel is taking when calculating late payment revenue; and is in accord with the methodology the Commission has taken on this question in other proceedings.[30]

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[25] Xcel Ex. 20 at 11 (Haworth).

[26] Tr. Vol. 1 at 60 and 69-71 (Haworth).

[27] Ex. 76 at 14 and LL-9 (La Plante Surrebuttal).

[28] OES Ex. 76 at 11 (La Plante Surrebuttal).

[29] OAG Ex. 47 at 20-24 (Smith Direct), OAG Ex. 49 at 25-27 (Smith Surrebuttal).

[30] OES Ex. 76 at 11(La Plante Surrebuttal); Tr. Vol. 2 at 114 (La Plante); *see generally,* Order, *In the Matter of an Application by CenterPoint Energy for Authority to Increase Natural Gas Rates in Minnesota*, MPUC Docket No. G008/GR-08-1075 at 38 (January 11, 2010) (E-Docket No. 20101-45867-01).

B. Rate Case Expense Amortization.

31. Xcel proposed to collect rate case expenses over a period of three years.[31]

32. While acknowledging that a utility's decision to initiate a new rate case follows from the interplay among a variety of business factors – including the rates of inflation, the cost of capital, the level of construction activity, the amount of customer usage and the application of new accounting rules – OES urges a minimum four-year period for the amortization of rate case expense. OES asserts that the average length of time between the last six rate cases (spanning the period from 1986 to the present) is 4.67 years, an amortization period of four years is reasonable.[32]

33. At the core of the dispute between the parties on this point is the appropriate treatment of the "four-year rate freeze" imposed upon gas rates following the merger of Northern States Power and New Century Energies. Xcel asserts that including the period of "rate freeze" into the calculation of the average time between rate cases unfairly distorts the average, because it was not permitted to file for an adjustment in its rates during this period.[33]

34. If the period of the four-year freeze is excluded from the calculation, and the time period between the three most-recently filed rate cases are averaged (*see,* MPUC Dockets G002/GR-04-1511; G002/GR-06-1429; and G002/GR-09-1153), the resulting period is less than 3 years.[34]

35. Because the more recent rate-making experience is a better guide to estimating the near future than the experience in the late 1980's and early 1990's, a three-year period for amortization of rate case expenses represents the better approach. Recovery of Xcel's rate case expenses over a period of three years is reasonable.[35]

C. Xcel Energy Foundation Expenses

36. Xcel proposes to include in its test year recovery of $16,210 for the administrative expenses associated with operating the Xcel Energy Foundation. This amount equals half of the $32,421 in expenses that Xcel originally sought to recover from ratepayers.[36]

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[31] Xcel Ex. 14 at 72 (Heuer Direct); OES Ex. 75 at 7 (La Plante Direct).

[32] OES Ex. 75 at 6-8 (La Plante Direct).

[33] Xcel Initial Brief, at 48-51.

[34] *Compare generally,* OES Ex. 75 at 6-7 (La Plante Direct).

[35] Xcel Ex. 14 at 30-31 (Heuer Direct); *but see,* OES Ex. 76 at 6-7 (La Plante Direct).

[36] Xcel Ex. 14 at 30 (Heuer Rebuttal); OES Ex. 75 at 3 (La Plante Direct); Ex. 76 at 5 (La Plante Surrebuttal).

37. Pointing to the Commission's treatment of these expenses in Xcel's most recent electric utility rate case, OES objects to the recovery of any administrative expenses relating to the Xcel Energy Foundation.[37]

38. Merely because the Commission has permitted recovery of 50 percent of the charitable contributions associated with Xcel Foundation, it does not follow that 50 percent of the foundation's expenses are likewise recoverable from ratepayers.[38]

39. While Xcel's request to recover half of the associated administrative expense differs from its earlier request (in MPUC Docket No. E002/GR-08-1065) to recover all of these expenses from its customers, the Applicant has not demonstrated that it is reasonable or consistent with the public interest to charge the Foundation's administrative costs to ratepayers as part of the cost of furnishing electric service.[39]

D. Medicare Part D Tax Benefits

40. On November 12, 2009, the Applicant pre-filed the direct testimony of Anne E. Heuer, which included a detailed description of Xcel's revenue requirements, rate base and income statement.[40]

41. Later, in its rebuttal testimony, Xcel proposed to increase the test-year revenue requirement by $254,000 to reflect recent changes in the Internal Revenue Code related to Medicare Part D prescription drug subsidies.[41]

42. Xcel asserts that as a result of the enactment of the Patient Protection and Affordable Care Act (PPACA) on March 23, 2010, the favorable tax treatment accorded to Medicare Part D prescription drug subsidies has been reduced. Beginning in 2013,

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[37] *Compare,* Order, *In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, MPUC Docket No. E002/GR-08-1065, at 23 ("The Commission concludes that in this case the Company has not demonstrated that it is reasonable or consistent with the public interest to charge the Foundation's administrative costs to ratepayers as part of the cost of furnishing electric service") <u>with</u> OES Ex. 75 at 3 (La Plante Direct) and OES Ex. 76 at 5 (La Plante Surrebuttal).

[38] *See,* Order, MPUC Docket No. E002/GR-08-1065, at 22 ("The Commission agrees with all parties that the historical practice and statutory standard of permitting up to 50% of a *utility's charitable contributions* to be charged to ratepayers reflects a policy judgment that these contributions have a significant public-interest function") (emphasis added).

[39] *Id.,* at 23 ("But the administrative costs associated with these contributions are one step removed from the contributions themselves and are less clearly entitled to any rate recovery, let alone the 100% rate recovery sought by the Company. And requesting full ratepayer funding of a separate institutional body to conduct, coordinate, and presumably, publicize, the Company's benevolent activities places this request even further outside the traditional parameters of rate-recoverable charitable contributions").

[40] Ex. 13 (Heuer Direct).

[41] Xcel Ex. 14 at 38-41 (Heuer Rebuttal).

Xcel will no longer be able to deduct retiree drug costs to the extent of the federal subsidy.[42]

43. Based upon this change in the tax code, during the first quarter of 2010, Xcel Energy wrote off $17 million from its financial statements to shareholders of previously recorded tax benefits.[43]

44. Xcel proposes to remove the negative deferred tax expense and associated rate base impacts from the test year. Additionally, Xcel proposes to spread over three years the expense of the deferred tax asset balance. This balance was accumulated through the recording of negative deferred tax expenses in anticipation of a future deduction.[44]

45. OES opposes the proposal on both procedural and substantive grounds. OES asserts that because the proposal was not detailed in the Applicant's pre-filed direct testimony – debuting during the rebuttal phase of the pre-hearing filings – the other parties to the proceeding are unduly prejudiced. OES likewise argues that the proposal is unbalanced because it does not sufficiently credit the offsetting of certain other health care costs which will be reduced as a result of the same legislation.[45]

46. Xcel has demonstrated good cause for not detailing in its submissions in November of 2009, the impact during the test year of legislation that was not finalized until March of 2010.[46]

47. It is reasonable and fair for the Commission to amortize the Applicant's Medicare Part D costs over a three year period – the same period recommended here for the recovery of ratemaking expenses. To the extent that offsets are known, any amortization should occur only after offsetting the decreases in costs that arise out of the new legislation.[47]

E. Residential Customer Charges

48. Xcel initially proposed to increase the customer charge for residential customers from $8.00 per month to $12.00 per month. In later rebuttal testimony, Xcel

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[42] *Id.*; *see generally,* Pub. L. 111-148 (March 23, 2010).

[43] OES Ex. 82 at 9 (St. Pierre Surrebuttal).

[44] Xcel Ex. 14 at 40-41 (Heuer Rebuttal).

[45] *See,* Xcel Ex. 14 at 38-41 (Heuer Rebuttal); OES Ex. 82 at 7-10 and MAS-S-1 (St. Pierre Surrebuttal).

[46] *Compare,* Second Pre-Hearing Order, OAH Docket No. 8-2500-21026-2 (February 8, 2010) with Remarks of the Honorable Nancy Pelosi to the 2010 Legislative Conference for National Association of Counties (March 9, 2010) ("[W]e have to pass the [health care reform] bill so that you can find out what is in it, away from the fog of the controversy") (http://www.speaker.gov/newsroom/pressreleases?id=1576).

[47] *See,* Xcel Ex. 14 at 38-41 (Heuer Rebuttal); OES Ex. 82 at 7-10 and MAS-S-1 (St. Pierre Surrebuttal).

reduced its proposed increase in the residential customer charge from $12.00 to $10.00 per month.[48]

49. As shown in Xcel's class cost of service study, the current average cost to serve a residential customer cost is $20.18 per month.[49]

50. These customer costs are incurred by virtue of the connection to the Applicant's gas system. The costs associated with such items "as constructing and maintaining infrastructure, reading meters, and conducting billing and collection services." Moreover, these costs are incurred even in those instances when a residential customer consumes no natural gas within a particular month.[50]

51. Xcel contends that in those instances where there is a gap between the fixed monthly cost of servicing a particular residential customer, and the customer charge assessed to that customer, the unrecovered cost of service will be shifted on to the per therm rates – and the bills of other utility customers. By contrast, recovering more customer costs in the Customer Charge reduces the subsidization between classes of ratepayers.[51]

52. Particularly in the instance of the owners of second homes and vacation properties, low monthly usage is a poor proxy for the assumption that the customer is either low-income or conservation-minded.[52]

53. A $10 per month residential customer charge represents less than 50 percent of the actual average cost of service to residential customers – thereby preserving the clarity and efficacy of existing conservation incentives.[53]

54. Increasing the residential customer charge by $2.00 – from $8.00 to $10.00 per month – is reasonable, similar to other adjustments made by the Commission and reduces the level of intra-class subsidies.[54]

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[48] Xcel Ex. 37 at AAL-1, Schedule 3, Line 8 (Liberkowski Direct).

[49] Xcel Ex. 36 at 7 and JPG-2, Schedule 2 (Gilroy Rebuttal).

[50] *See,* Order, *In the Matter of an Application by CenterPoint Energy for Authority to Increase Natural Gas Rates in Minnesota*, MPUC Docket No. G008/GR-08-1075, at 56 (January 11, 2010).

[51] Xcel Ex. 37 at 11-12 (Liberkowski Direct).

[52] *See,* Order, MPUC Docket No. G008/GR-08-1075, at 57 ("Further, there appears to be no public-interest justification for this subsidy, at least not at this level…. Nor are all low-usage customers low-income; some, for example, are seasonal residents, incurring negligible usage charges during the high-bill season. These facts militate against the subsidy levels that would result from leaving current customer charges in place").

[53] *Id.,* ("Neither does encouraging conservation, a ratemaking principle mandated by statute, justify a subsidy of this magnitude. Even at the new rates proposed, customer charges constitute just a fraction of customers' bills; clear and effective conservation incentives remain in place").

[54] *Id.,* at 56; Order, *In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to Increase Rates for Natural Gas Service in Minnesota*, MPUC Docket No. G007,011/GR-08-835, at 18—20 (June 29, 2009); Xcel Ex. 37 at 11-12 (Liberkowski Direct).

55. The resulting impacts to residential customers are modest and would not result in rate shock.[55]

F. Return on Equity (ROE)

56. In order to establish just and reasonable natural gas rates, the Commission must determine a fair rate of return on common equity capital, a fair capital structure, and a fair overall rate of return for Xcel Gas.[56]

57. A fair rate of return is a rate which, when multiplied by the rate base, will give the utility a reasonable return on its total investment. A reasonable rate of return enables a public utility not only to recover its operating expenses, depreciation, and taxes, but also allows it to compete for funds in capital markets.[57]

58. Under Minnesota law, doubts as to reasonableness of a rate of return are to be resolved in favor of the consumer.[58]

59. For Xcel to attract capital, its rate of return must at least equal the rate of return for the best alternative opportunity with similar risk.[59]

60. The DCF method uses the current dividend yield and the expected growth rate of this yield to determine a required rate of return on an investment opportunity. It is a reasonable, market-oriented approach to determine a fair ROE for Xcel.[60]

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[55] Ex. 38 at 6 (Liberkowski Rebuttal).

[56] Minn. Stat. § 216B.03 (2008). Note: Because the nature of its natural gas operations – as distinct from its other operations – may be important to the Return on Equity (ROE) analysis, the Applicant may be referred to as "Xcel Gas" in the findings below.

[57] Minn. Stat. § 216B.16, subd. 6 (2008); *Federal Power Commission v. Hope Natural Gas Co*., 320 U.S. 591, 603 (1944) (a just and reasonable rate assures a "return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks"); *Bluefield Waterworks & Improvement Co. v. Public Serv. Comm'n of West Virginia,* 262 U.S. 679, 693 (1923) (a utility's return "should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties"); OES Ex. 52 at 4-6 (Griffing Direct).

[58] Minn. Stat. § 216B.03 (2008).

[59] OES Ex. 52 at 6-7 (Griffing Direct).

[60] *Id.,* at 6-8; *accord*, *In the Matter of an Application by CenterPoint Energy for Authority to Increase Natural Gas Rates in Minnesota*, MPUC Docket No. G008/GR-08-1075 (January 11, 2010); *In the Matter of an Application by Northern States Power Company, d/b/a Xcel Energy for Authority to Increase Electric Rates in Minnesota*, MPUC Docket No. E002/GR-08-1065 (October 23, 2009); *In the Matter of an Application by Minnesota Power for Authority to Increase Electric Rates in Minnesota*, MPUC Docket No. E015/GR-08-415 (May 4, 2009).

61. The DCF model uses publicly-available information on share prices and the estimates of utility industry experts. For example, future annual dividends are calculated by applying growth rate estimates to a company's current annual dividend.[61]

62. Because Xcel Gas is a wholly owned subsidiary of Xcel Energy, Inc. (Xcel Energy), and its stock is not publicly traded, a direct DCF analysis is not possible. However, it is possible to perform DCF analysis on similar publicly-traded companies.[62]

a. OES Discounted Cash Flow Analysis

63. Because the Applicant is requesting an ROE only for Xcel Gas, OES argued that it is necessary to perform DCF analysis on two comparison groups and to compare the results. It analyzed a group of:

(1) comparable natural-gas local distribution companies (LDCs) that are publicly traded and have similar investment risk; and,

(2) public utilities that include natural gas and retail electric power units.[63]

64. For the group of natural-gas utilities presenting similar investment risk, OES sought companies that:

(1) publicly traded its stock;

(2) paid dividends and had a positive growth-rate;

(3) were not now being acquired or undergoing a merger;

(4) were based in the United States;

(5) had a similar credit rating to Xcel; and,

(6) had a two-year mean of 60 percent of net income derived from regulated natural-gas operations.[64]

65. OES's selection criteria outlined above resulted in a group of eight natural-gas companies.[65]

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[61] OES Ex. 52 at 8-9 (Griffing Direct).

[62] *Id.,* at 9.

[63] *Id.,* at 9-10.

[64] OES Ex. 52 at 12-13 (Griffing Direct) and OES Ex. 53 at MFG-2, Schedule 3 (Griffing Direct Attachments).

[65] OES Ex. 52 at 17-22 (Griffing Direct).

66. The OES used a similar evaluation process to select companies for the "combination comparison group." The OES used the same first five factors outlined above, but used a modified version of factor 6 and a new factor, 7. The new and modified factors are:

(6) two-year mean of 10 percent of net income or another earnings indicator derived from regulated natural gas operations; and

(7) two-year mean of 60 percent of net income or another earnings indicator derived from regulated natural gas and electric operations.

The selection criteria resulted in a group of twelve combination companies.[66]

67. Having determined groups of companies with comparable investment risks comparable to Xcel Gas, the OES then estimated the expected growth rate of dividends and the expected dividend yield of each company in the comparable groups.[67]

68. OES relied upon projected growth rates provided by three investor services companies, The Value Line Investment Survey, a widely used service (Value Line), Zacks Investment Research (Zacks), an investor services company and Thomson Financial Network estimates provided on Yahoo! Finance (Yahoo! Finance).[68]

69. OES used only the projected Earnings Per Share (EPS) growth rate in its DCF analysis.[69]

70. In surrebuttal testimony, OES updated its DCF analysis to reflect more current information. For both the LDC Group and the Combination Group, OES used the average of closing prices on the 20 trading days between May 3 and 28, 2010.[70]

71. For the natural-gas comparison group, OES used the Value Line EPS estimates from Value natural-gas company reports issued on June 11, 2010, the Zacks' estimates from the Zacks' website on June 8, 2010, and the Yahoo! First Call EPS estimates from the Yahoo! Finance website on June 8, 2010.[71]

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[66] OES Ex. 52 at 12-13 and 27-31 (Griffing Direct) and OES Ex. 53 at MFG-2, Schedule 3 (Griffing Direct Attachments).

[67] OES Ex. 52 at 31 (Griffing Direct).

[68] *Id.,* at 32-33 (Griffing Direct).

[69] *Id.,* at 32-35 (Griffing Direct).

[70] OES Ex. 57 at 4 (Griffing Surrebuttal); OES Ex. 58 at MFG-S-1, at 1-4; MFG-S-3, 1-6 (Griffing Surrebuttal Attachments).

[71] OES Ex. 57 at 4-5 (Griffing Surrebuttal); OES Ex. 58 at MFG-S-8, at 1-40 (Griffing Surrebuttal Attachments).

72. For the combination comparison group, OES drew EPS estimates for these companies from the March 26, May 7, May 28 and June 11, 2010 issues of the Value Line reports. It compiled Zacks' estimates from the Zacks' website and Yahoo! First Call EPS estimates from the Yahoo! Finance website, on June 8, 2010.[72]

73. OES used the highest reported dividends annualized from Zacks for the LDC Group and Combination Group or from Value Line for LDC Group.[73]

74. The range of the updated ROE for the LDC Group companies reflected the differences among the three sets of expert analysts' growth-rate estimates. The ROE range spanned from a low of 7.96 percent to a high of 9.86 percent.[74]

75. Believing that the mean value for the LDC Group would set rates too low, OES used the high end of the range of the updated analysis – 9.86 percent.[75]

76. OES also updated its DCF analysis for the combination comparison group. It obtained an updated mean ROE for the Combination Group of 10.95 percent, within a range that spanned from 10.13 percent to 11.71 percent.[76]

77. A Combination ROE of 10.95 percent is reasonable. It is greater than any of the four awards for combination natural gas-and-electric companies in the *Public Utilities Fortnightly 2009 ROE Survey* and was greater than any of six joint natural gas-and-electric ROE awards received by companies in the *Regulatory Research Associates* report for the four most recent quarters.[77]

78. The OES originally recommended a weighted ROE of 9.67 percent. In its surrebuttal testimony, the OES revised its weighted ROE upward to 10.09 percent.[78]

b. Xcel Discounted Cash Flow Analysis

79. Xcel originally sought recovery of a weighted ROE of 11.00 percent. In its rebuttal testimony, however, Xcel revised its proposed ROE downward to 10.60 percent.[79]

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[72] OES Ex. 57 at 5 (Griffing Surrebuttal); OES Ex. 59 at MFG-S-9, at 1-60 (Griffing Surrebuttal Attachments).

[73] OES Ex. 57 at 5-6 (Griffing Surrebuttal); OES Ex. 58 at MFG-S-8, at 1-24 (Griffing Surrebuttal Attachments); OES Ex. 59 at MFG-S-9, at 13-36 (Griffing Surrebuttal Attachments).

[74] OES Ex. 57 at 6 (Griffing Surrebuttal); OES Ex. 58 at MFG-S-2, Schedule 1 (Griffing Surrebuttal Attachments).

[75] OES Ex. 57 at 5-6 (Griffing Surrebuttal).

[76] *Id.,* at 8 (Griffing Surrebuttal); OES Ex. 58 at MFG-S-4, Schedule 1 (Griffing Surrebuttal Attachments).

[77] OES Ex. 57 at 8 (Griffing Surrebuttal).

[78] OES Ex. 52 at 44 (Griffing Direct); OES Ex. 57 at 8 (Griffing Surrebuttal).

[79] Xcel Ex. 9 at 2-3 (Reed Direct); Xcel Ex. 10 at 1-2 and 14-15 (Reed Rebuttal).

80. Xcel undertook a DCF analysis that compares returns from natural gas and combination company proxy groups.[80]

81. Xcel weights the Combination Proxy Group at 60 percent and the Gas Proxy Group at 40 percent.[81]

82. Because Xcel is requesting an ROE for its natural-gas operations, it is appropriate to assign a greater weight to the natural-gas LDC Group ROE than to the Combination Group ROE.[82]

83. OES weighted the contribution of the Combination Group by 21 percent on the grounds that the Applicant's natural-gas LDC represents 21 percent of Xcel's overall rate base. Likewise, OES asserted that the weight for Gas Proxy Group should be 79 percent, rather than the 40 percent weighting urged by Xcel.[83]

84. In an apparent acknowledgement of this claim, in its initial brief, Xcel proposes to switch its earlier 60 – 40 weightings; now urging a weighting of the Gas Proxy Group at 60 percent and the Combination Proxy Group at 40 percent. While this adjustment narrows the distance between it and OES (60 percent Gas Group / 40 percent Combination Group, as opposed to 79 percent Gas Group / 21 percent Combination Group), this proposal was not developed during the evidentiary hearing.[84]

85. Regardless, both a 60 percent weighting and a 40 percent weighting for the Combination Proxy Group's ROE skews the DCF analysis. Such weightings place too much emphasis on the electricity operations of the combination firms and their accompanying higher ROE. Either weighting would overstate the ROE for Xcel Gas' natural-gas LDC operations.[85]

c. Reasonableness, CAPM and *Public Utilities Fortnightly*.

86. The Capital Asset Pricing Model (CAPM) is used to determine an appropriate rate of return of an asset. The model takes into account the asset's sensitivity to non-diversifiable, systematic risk (represented by the quantity beta (â)), the expected return of the market and the expected return of a risk-free asset.[86]

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[80] Xcel Ex. 9 at 14-17 and 50 (Reed Direct); OES Ex. 52 at 17-28 and 56 (Griffing Direct).

[81] Xcel Ex. 9 at 29 (Reed Direct).

[82] OES Ex. 57 at 12 (Griffing Surrebuttal); *compare also,* Order, MPUC Docket E002/GR-08-1065 ("The goal in setting an authorized return on equity is to reflect as accurately as possible the market situation Xcel faces").

[83] OES Ex. 52 at 42 and 61-62 (Griffing Direct).

[84] *Compare,* Xcel Initial Brief at 63-64.

[85] OES Ex. 52 at 61-62 (Griffing Direct); OES Ex. 57 at 10 (Griffing Surrebuttal) (citing Xcel Ex. 10 at 7 (Reed Rebuttal).

[86] *See,* OES Ex. 52 at 44-45 (Griffing Direct).

87. OES urges caution in the use of the CAPM on the grounds that it is unduly dependent upon the analyst choice of inputs and variables. It urges the Commission to only use the CAPM as a broad, if imprecise, check upon the overall reasonableness of the DCF analyses.[87]

88. The yield on 90-Day Treasury Bills is virtually riskless, devoid of default risk and subject to a negligible amount of interest rate risk. However, the yields of short-term Treasury Bills do not reflect the factors influencing long-term securities, such as common stock.[88]

89. Although it is not a riskless asset, and thus may upwardly bias a CAPM analysis, the average yield on a 20-year Treasury bond, closely approximates a riskless asset. The average yield on such bonds during the period between March 23 and April 22, 2010 was 4.57 percent.[89]

90. As reflected in the Value Line Investment survey of March 12, 2010, the average beta for seven of the eight companies in the OES natural-gas LDC Group is 0.66. OES eliminated the eighth company – WGL Holdings – from its analysis on the grounds that it had an unreasonably low Discounted Cash Flow ROE. The average beta for the eleven companies in the OES Combination Group is 0.69.[90]

91. The arithmetic mean of returns during the period between 1926 and 2009 for Large Company Stocks (the S&P 500 Composite Index) is 11.8 percent. The arithmetic mean of returns during the period between 1926 and 2009 for Long-Term Government Treasury Bonds at 5.8 percent. The difference between these two percentages – 6.0 percent – equals the risk premium.[91]

92. The OES's CAPM analysis yielded an ROE value of 8.55 percent for the natural-gas LDC Group and an ROE of 8.71 percent for the OES Combination Group. OES concluded that these CAPM results are close to the bottom of the range of DCF analyses and are too low to be reasonable.[92]

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[87] *Id.,* at 44-49 (Griffing Direct).

[88] *Id*., at 45 (Griffing Direct).

[89] OES Ex. 52 at 46 (Griffing Direct) and OES Ex. 53 at MFG-11, Schedule 1, page 1 of 1 (Griffing Direct Attachments).

[90] OES Ex. 52 at 34 and 47 (Griffing Direct) and OES Ex. 53 at MFG-11, Schedule 2 (Griffing Direct Attachments).

[91] OES Ex. 52 at 47-48 (Griffing Direct) (citing *Stocks, Bonds, Bills, and Inflation Yearbook,* (Ibbotson Associates, 2010)).

[92] OES Ex. 52 at 48-49 (Griffing Direct) and OES Ex. 53 MFG-11, Schedule 4 (Griffing Direct Attachments).

93. As an additional check upon the reasonableness of its DCF analyses, the OES undertook an analyses of recent ROE decisions as reported in the *Public Utilities Fortnightly*.[93]

94. The range of the updated ROE for the LDC Group companies, reflecting the differences among the three sets of expert analysts' growth-rate estimates, was from a low of 7.96 percent to a high of 9.86 percent.[94]

95. The mean ROE for the OES Combination Group of 10.95 percent was greater than any of the four awards for combination natural gas-and-electric companies in the *Public Utilities Fortnightly* 2009 ROE Survey and was greater than any of six joint natural gas-and-electric ROE awards received by companies in the *Regulatory Research Associates* report for the four most recent quarters. Based upon these reports, OES concluded that 10.95 percent was a reasonable combination ROE.[95]

96. Applying the 79 percent weight to the LDC ROE of 9.86 percent and a weight of 21 percent to the Combination ROE of 10.95 percent, OES obtained its recommendation of an ROE of 10.09 percent for Xcel Gas.[96]

97. The *Public Utilities Fortnightly* survey results are consistent with, and lend support to, a finding that a weighted ROE of 10.09 percent is reasonable.[97]

G. Cost of Long-Term Debt and Capital Structure

98. In its rebuttal testimony, Xcel proposed the following capital structure:

Xcel's Revised Capital Structure

Long-Term Debt	46.74%
Short-Term Debt	0.80%
Common Stock Equity	52.46%[98]

99. Xcel argued that because long-term debt forecasts have decreased significantly since the filing of its initial application in November 2009, ratepayers will benefit from obtaining capital for projects at favorable interest rates.[99]

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93 OES Ex. 52 at 44, and 49-51 (Griffing Direct).

94 OES Ex. 57 at 6 (Griffing Surrebuttal) and OES Ex. 58 at MFG-S-2, Schedule 1 (Griffing Surrebuttal Attachments).

95 OES Ex. 57 at 8 (Griffing Surrebuttal).

96 OES Ex. 57 at 8 (Griffing Surrebuttal).

97 OES Ex. 52 at 44 (Griffing Direct); OES Ex. 57 at 8 (Griffing Surrebuttal).

98 *See,* OES Ex. 57 at 9 (Griffing Surrebuttal).

99 *See,* Ex. 11, at Schedule 6A, 6B, and 6C (Tyson Direct); Ex. 12, at 4 (Tyson Rebuttal); Tr. Vol. 1 at 30 (Tyson).

100. The OES agreed that Xcel's revised proposed capital structure is reasonable.[100]

101. OES accepted Xcel's cost of short-term and long-term debt for purposes of recommending an overall cost of capital for Xcel.[101]

102. During the evidentiary hearing, Xcel reduced its cost of long-term debt from 6.44 percent to 6.40 percent.[102]

103. Based upon the then-most current information, Xcel and OES determined that the overall cost of long term debt was 6.40 percent and the weighted cost of long term debt was 2.99 percent.[103]

104. OAG did not agree to the proposed capital structure. It argued that the structure agreed-upon between OES and Xcel should be rejected. OAG asserted that the proposal came so late in the proceedings that it represented an untimely, unwelcome and unprecedented change.[104]

105. OAG asserted that a principal defect of the revised capital structure is that it inflates the amount of borrowing claimed for the test year, with debt that is properly attributable to other years.[105]

106. Xcel increased the size of the August 2010 bond issue to $500 million in two tranches: (i) a 5-year tranche of $250 million with a coupon of 1.95 percent; and (ii) a 30-year tranche of $250 million with an estimated coupon rate of 4.85 percent.[106]

107. Based on the actual coupon rates for the $500 million of long term debt issued by the Company in August 2010, the Company's overall cost of long term debt is 6.36 percent and the weighted cost of long term debt is 2.97 percent.[107]

108. Xcel's cost of short-term and long-term debt are reasonable.[108]

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[100] OES Ex. 57 at 9 (Griffing Surrebuttal).

[101] OES Ex. 88 (Johnson evidentiary workpapers); Tr. Vol. 2 at 90 (Griffing); Tr. Vol. 1 at 25-26 (Tyson); OES Initial Brief, at 58.

[102] Tr. Vol. 1, at 25-26 (Tyson).

[103] Tr. Vol. 1, at 25-26 and 37-38 (Tyson); Ex. 60, Revised MFG-S-5 (Griffing Surrebuttal).

[104] OAG Initial Brief, at 10-12.

[105] Tr. Vol. 1 at 37-38.

[106] *Compare,* Ex. 11, at Schedule 6A, 6B, and 6C (Tyson Direct); Ex. 12, at 4 (Tyson Rebuttal); Tr. Vol. 1 at 30 (Tyson) <u>with</u> E-Docket No. 20109-54372-01.

[107] *See,* E-Docket No. 20109-54372-01.

[108] Tr. Vol. 2, at 90 (Griffing).

109. The resulting cost of capital for the test year is as follows:

Capitalization	Amount in Thousands	Percent of Total Capitalization	Return on Equity	Weighted Cost of Capital
Total Debt (Short Term and Long Term)	$2,775,329	47.53 %		2.98 %
Net Common Equity	$3,063,699	52.47 %	10.09 %	5.29 %
Total Capitalization	$5,839,028	100.00 %		8.27 %

H. Employee Compensation

110. Xcel's proposed recovery of base compensation plus a portion of costs related to the company's annual incentive plan ("AIP"). The 2010 annual incentive compensation costs included in the test year are $927,855, which is 70 percent of the amount the Company has targeted to spend. Xcel likewise proposes to refund to ratepayers any undisbursed incentives.[109]

111. The OAG recommends that the Commission deny recovery of the $927,855 related to AIP. OAG asserts that wages and salaries on average grew by 2.6 percent in 2008 and by 1.4 percent in 2009.[110]

112. Xcel's actual merit wage increase for 2009 was approximately 1.3 percent.[111]

113. The Company's total cash compensation levels, including the AIP at target levels, are one percent below the market for other utilities, and four percent below market for similar-sized utilities. If AIP were removed from the total cash compensation, the Company's total cash compensation levels would fall to 12 and 15 percent below the market respectively when compared to other utilities and similar-sized utilities.[112]

114. As a part of Xcel's 1992 combined natural gas and electric rate proceeding, the Commission agreed to allow the Company to recover the full amount of

[109] Ex. 15, at 4 and 12 (Reed Direct).

[110] Ex. 47, at 26-27 (Smith Direct).

[111] Ex. 16, at 6 (Reed Rebuttal).

[112] Ex. 15, at 6 (Reed Direct).

its incentive plan costs, subject to refund in the event that management did not make a full award of annual incentive to employees.[113]

115. The AIP is a reasonable cost of providing utility service and is needed to provide adequate and competitive compensation. The structure and operation of the AIP promotes behavior that benefits ratepayers and shields them from financial risk.[114]

I. Sales Forecast – Interruptible Class

116. Xcel and OES agree that the sales forecast for this proceeding should be a combination of the actual weather normalized sales for the period of January through April 2010 and the OES forecast for May through December.[115]

117. The OAG asserts that that the proposed sales forecast models do not consider the effects of the price of natural gas and result in a large increase – 31.68 percent – for interruptible service customers.[116]

118. Xcel's sales forecast models do not integrate the impact of natural gas pricing for those classes of customers (Residential, Small Commercial, and Large Commercial) for which price improves the statistical significance of results produced by the models.[117]

119. Moreover, as checks upon the reasonableness of its forecasting models, Xcel undertakes graphical inspection of each model's error terms, comparisons with monthly sales history and comparisons with monthly customer usage data.[118]

120. The actual weather-normalized sales during January through April 2010 for the proposed Test Year indicated sales for the Residential, Commercial, Demand, Interdepartmental, and Transportation classes were lower than the originally filed Test Year sales, while the sales for the Interruptible and Generation classes were higher.[119]

121. OAG asserts that because of the variance between forecasted sales and actual sales during January through April for the Interruptible Class, Xcel's sales forecast is not reliable.[120]

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[113] MPUC Docket Nos. E002/GR-92-1185 and G002/GR-92-1186.

[114] *See,* Ex. 15, at 12 (Reed Direct).

[115] Ex. 19, at 3 (Marks Rebuttal).

[116] OAG Ex. 47 at 5 (Smith Direct); OAG Ex. 49 at 10 (Smith Surrebuttal).

[117] Ex. 19, at 4-7 (Marks Rebuttal).

[118] Ex. 18, at 16-17 (Marks Direct).

[119] Ex. 19, at 8-9 (Marks Rebuttal).

[120] OAG Initial Brief, at 8.

122. In recent years, there have been sizeable deviations between the forecast and actual weather-normalized sales during January through April, within all customer classes. Within the interruptible class, variations from month to month can follow from the level of interruptions and the comparative cost of alternative fuels.[121]

123. The combination of sales forecast data and weather normalized sales is most likely to predict actual test year experience. Xcel's sales forecast is reasonable.[122]

J. Small Commercial Customer Charge

124. Xcel and OES agreed that the Small Commercial Customer Charge should be increased from $20.30 to $25.00.[123]

125. This increase reflects a movement towards the cost, at $30.00, as indicated in the CCOSS.[124]

126. At this level, Xcel will maintain the current per therm Distribution Charge relationship between Small and Large Commercial Customers.[125]

127. OAG urges the Small Commercial Customer Charge remain at $20.30.[126]

128. Because the recommended increase, from $20.30 to $25.00, moves closer toward the actual cost of service and maintains reasonable price relationships among classes of customer, the proposal is reasonable and should be accepted.[127]

K. Relocation Capital Expenditures.

129. As a part of its rate case application, the Company included a Test Year relocation capital expenditure budget of $9.3 million.[128]

130. The budget for relocation capital expenditures has three principal components:

- $2.28 million for a set of larger projects.

[121] Ex. 19, at 9 (Marks Rebuttal).

[122] Ex. 18, at 5-17 (Marks Direct).

[123] Ex. 37, at 18 (Liberkowski Direct); OES Ex. 64 at 10 (Shaw Surrebuttal).

[124] Ex. 37, at 18 (Liberkowski Direct).

[125] *Id*.

[126] OAG Initial Brief, at 28-29.

[127] Ex. 37, at 18 (Liberkowski Direct).

[128] Ex. 21, at 12 (Kaphing Direct).

- $4.045 million for a variety of small to medium sized projects – some of which have yet to be identified.

- "Routine" gas relocation projects anticipated in 2010.[129]

131. If a City is planning a construction project, it will normally contact the utilities whose facilities are located within the project area. If the utility's existing facilities will conflict with the City's construction, the utility will be required to relocate these facilities.[130]

132. If the construction will not interfere with the utility's facilities, the utility may still to update or replace its facilities during the time that the roadways in the project area will be disturbed.[131]

133. In its budget process, Xcel uses the term "relocation project" in two different ways. It uses this term to describe efforts to relocate facilities that are in direct conflict with local construction projects and those facility upgrades that are convenient to accomplish alongside other construction.[132]

134. Xcel's actual experience in 2009 showed an incremental $0.8 million increase in small and medium level gas relocation project activities over and above the Company's prior three-year average – from 2006 through 2008.[133]

135. SRA disputed the amount and breadth of the Company's proposed relocation capital expenditures.[134]

136. No witnesses recommended particular deductions to the Company's relocation capital expenditure budget. Instead, SRA recommends disallowance of $3.65 million so as to better predict the amount of actually incurred costs.[135]

137. In PUC Information Request Number 4, Commission Staff sought from Xcel detail as to amounts that were spent by the Company, in previous years, in additional relocation projects identified during or after June.[136]

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[129] Ex. 22, at 32-33 (Kaphing Rebuttal).

[130] Ex. 22, at 35 (Kaphing Rebuttal).

[131] *Id*.

[132] Tr. Vol. 4 at 34 – 38.

[133] Ex. 22, at 38 (Kaphing Rebuttal).

[134] Exs. 89 (Ahl Direct), 92 (Maczko Direct), 93 at 3 (Maczko Surrebuttal) and 94 (Thompson Direct).

[135] Transcript, Vol. 3, at 20; SRA Initial Brief, at 9.

[136] Ex. 96.

138. The Company's response to this request was admitted into the record as Exhibit Number 96. Xcel asserted that during the years 2006 through 2009, it spent, on average, $1.9 million in relocation capital expenditures during and after June.[137]

139. On May 10, 2010, the Minnesota Office of Pipeline Safety issued an "Alert Notice" requires the Company to, "clear sewer laterals in one form or another, either by extra excavation or by camera work." The additional work has led to an increase in the Company's relocation and renewal costs of approximately 12 percent.[138]

140. If the Company does not spend its full budget on relocation projects, the remaining funds are pent on Company-initiated "renewal projects." The Company's actual spending for reconstruction has exceeded its reconstruction budget for the years 2007 through 2009.[139]

141. Because of the costs that Xcel will incur during 2010 as a result of identified projects, compliance with the Office of Pipeline Safety Alert Notice and the backlog of utility renewal projects, inclusion of $9.3 million in the Test Year relocation capital expenditure budget, is reasonable.[140]

III. ISSUES THAT WERE RESOLVED BETWEEN OES AND XCEL

142. The OES and Xcel resolved their differences as to the following issues:

A. Test year revenue to reflect the Commission's final Order regarding Xcel's remaining lives study (Docket No. G,E002/D-10-173);

B. Adjustment to gas-in-storage in rate base;

C. Removal of the Grand Forks Plant from the 2010 Test Year;

D. New Area Surcharge for Taylors Falls;

E. Exclusion of 2009 wage increase adjustment from the Test Year;

F. Employee expenses;

G. Incentive compensation;

H. Removal of costs of corporate aviation;

[137] Ex. 96. Attachment A.

[138] Tr. Vol. 4 at 42. As noted by Mr. Kaphing, the Company currently has a petition pending in Commission Docket No. G002/M-10-422 for deferral of costs associated with a Plan to identify and remedy potentially dangerous conflicts between the natural gas facilities and city sewer facilities.

[139] Ex. 96.

[140] *See generally,* Tr. Vol. 4 at 19-20.

I. Increase in limited firm revenue;

J. Increase in late payment revenue;

K. Reduction of expenses for Service Company allocations;

L. Pension;

M. Gas delivery operation and maintenance (O&M) all categories;

N. Test year revenue to reflect the Commission's final Order regarding Xcel's remaining lives study (Docket No. G,E002/D-10-173);

O. Test year adjustments related to uncollected contribution in aid of construction (CIAC) and payment of over-collected CIAC to the HeatShare program;

P. Marketing, economic development, gas sales and advertising expense;

Q. HomeSmart;

R. Sales forecast;

S. Pre-filing of sales forecast data;

T. Conservation improvement program (CIP);

U. Class revenue allocation;

V. Customer charges except as to Residential Customers;

W. Class cost of service study;

X. Depreciation expense;

Y. Legal expense;

Z. Duplicate donations;

AA. Agency Service and Sales to Others-MN Late Payment revenues;

BB. Cost of long-term debt;

CC. Interest synchronization;

DD. Cash working capital;

EE. Tariffs;

FF. Reporting information related to unusual construction charges, waiving of CIAC in competitive situations; and joint trenching; and

GG. Revenue apportionment methodology.[141]

143. Item E (Employee expenses) and item F (Incentive compensation) were inadvertently omitted from the list of resolved issues filed by Xcel on July 9, 2010. The OES examined but did not contest these special expense issues in the rate case.[142]

A. Adjustment to Gas-in-Storage in Rate Base.

144. Xcel included $42,699,000 of gas–in-storage in its test-year rate base.[143]

145. A change in the price of natural gas can affect the balance of gas-in-storage during the test year.[144]

146. OES agreed with Xcel's proposal to reduce the gas-in-storage balance to reflect the most recent information available regarding levels of natural gas prices – $5.135 per MMBtu. It is reasonable for the Commission to reduce the gas-in-storage balance in the rate base by $2,797,000.[145]

147. Xcel agreed that an adjustment to gas-in-storage inventory was appropriate and recommended using a three-year average of New York Mercantile Exchange (NYMEX) futures. This approach to calculating the adjustment in projected gas-in storage (with updated year-end level including actual data for December 2009 to April 2010) results in a reduction in test-year gas-in storage of $855,000.[146]

148. OES agreed that Xcel's proposed adjustment is reasonable and effectively addresses the volatility in natural gas prices.[147]

[141] *See,* OES Initial Brief, at 4-64.

[142] *Id.* at 4, note 1; OES Ex. 83 at 39 (Johnson Direct); OES Ex. 75 at 6-7 (La Plante Direct).

[143] Xcel Ex. 13 at AEH-1, Schedule 6 Page 2, Line 8 (Heuer Direct) and OES Ex. 75 at 2 (La Plante Direct).

[144] OES Ex. 75 at 2 and LL-3 (La Plante Direct).

[145] OES Ex. 75 at 3 and LL-3 at 4 (La Plante Direct); OES Ex. 75 at 3 and LL-2 (La Plante Direct).

[146] Xcel Ex. 14 at 13 (Heuer Rebuttal); OES Ex. 76 at 2 (La Plante Surrebuttal).

[147] OES Ex. 76 at 2 (La Plante Surrebuttal).

B. Removal of the Grand Forks Plant from the 2010 Test Year.

149. Xcel proposed to recover in rates costs of the Grand Forks production plant.[148]

150. OES recommended, in both the instant rate case and in Xcel's related 2010 Depreciation Filing proceeding, disallowance of the costs of the Grand Forks production plant. Because the Grand Forks plant is currently inoperable and Xcel has no plans to resume operations of the plant, the OES recommended specific adjustments to remove associated costs, as follows:

- exclude from the rate base the cost of Grand Forks plant, $921,000;
- exclude the related depreciation reserve of Grand Forks plant, $885,000;
- exclude accumulated deferred taxes-Grand Forks plant, $15,000;
- exclude related depreciation expense of Grand Forks plant, $14,000; and
- include annual deferred tax expense-Grand Forks plant, $6,000.[149]

151. It is reasonable for the Commission to approve the following revised adjustments to the test-year revenue requirement to exclude the State of Minnesota gas utility portion of the Grand Forks plant and the related deferred taxes.[150]

C. New Area Surcharge for Taylors Falls.

152. OES recommended that the Commission deny $202,000 of Distribution Plant in the rate base for Xcel's Taylors Falls project.[151]

153. Xcel agreed to remove the Taylors Falls project from rate base and thereby reduce the rate base category of Distribution Plant by $202,000. Likewise, the Company and the OES agree that no adjustment is necessary for depreciation expense, depreciation reserve, and deferred income taxes because the Taylors Falls plant is not considered depreciable plant and the plant balance was reduced by the surcharge revenue.[152]

154. It is reasonable to reduce rate base by $202,000 in Distribution Plant for the Taylors Falls project.[153]

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[148] *Id.* at 8-9; Xcel Ex. 14 at 8-10 (Heuer Rebuttal).

[149] *See, In the Matter of Northern States Power Company's, a Minnesota Corporation, Request for Approval of the Annual Review of Remaining Lives Depreciation for Electric and Gas Production and Gas Storage Facilities for 2010* (Docket E,G002/D-10-173); OES Ex. 75 at 11 (La Plante Direct); OES Ex. 75 at 12 and LL- 7 (La Plante Direct).

[150] Xcel Ex. 14 at 7-10 (Heuer Rebuttal); OES Ex. 76 at 7-9 (La Plante Surrebuttal).

[151] OES Ex. 79 at 23-24 (St. Pierre Direct).

[152] Xcel Ex. 14 at 11 (Heuer Rebuttal); Xcel Ex. 14 at AEH-2, Schedule 4 (Heuer Rebuttal); OES Ex. 82 at 7 (St. Pierre Surrebuttal).

[153] OES Ex. 82 at 7 (St. Pierre Surrebuttal).

D. Exclusion of 2009 Wage Increase Adjustment from the 2010 Test Year.

155. In its initial submissions, Xcel made a test-year adjustment to reflect increases in 2009 non-bargaining and non-executive employee wages. Xcel stated that this was a tentative measure, because the 2 percent wage increase was not finally agreed upon. This determination would come after its operation and maintenance (O&M) budgets were complete for the year 2010. In the meanwhile, however, Xcel made an adjustment to the income statement in the 2010 Test Year to add the effect of this increase to employee labor for the year 2010. The effect of the adjustments was to increase the administrative and general expense by $236,000 and decrease federal and state income tax expense by $98,000, for a total increase in the overall revenue deficiency by $236,000.[154]

156. Later, in response to OAG Information Request No. 214, Xcel eliminated this adjustment from the test year. Xcel indicated that the adjustment was unnecessary because it was already reflected in its 2010 budget. Elimination of the 2009 wage increase adjustment from the test year is reasonable.[155]

E. Employee Expenses.

157. Xcel made a test-year adjustment to reduce employee expenses based on the findings in its last electric rate case. Following that rate case, Xcel "developed new employee guidelines that provide employees with more detailed instruction on the appropriate reimbursement of costs and the associated accounting." Notwithstanding the change, the new guidelines were not in place prior to the budget development for the current rate case. Accordingly, Xcel made an adjustment to reduce employee expenses in this rate case by $107,608 "similar to" the adjustment in the test year of its last electric rate case.[156]

158. Xcel's proposed reduction to the test-year level of employee expenses is reasonable.[157]

F. Incentive Compensation.

159. Xcel proposed to recover $927,885 of incentive compensation in its test year.[158]

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[154] Xcel Ex. 13 at 67 (Heuer Direct); OES Ex. 83 at 40 (Johnson Direct).

[155] Xcel Ex. 14 at 17 (Heuer Rebuttal); OES Ex. 83 at 40 (Johnson Direct); OES Ex. 84 at MAJ-7, Column (j) and MAJ-33 (Johnson Direct Attachments).

[156] Xcel Ex. 13 at 66 (Heuer Direct) and OES Ex. 83 at 38 (Johnson Direct); *See generally, In the Matter of the Application of Northern States Power Company d/b/a Xcel Energy for Authority to Increase Rates for Electric Service in Minnesota*, MPUC Docket No. E002/GR-08-1065.

[157] OES Ex. 83 at 39 (Johnson Direct).

160. The proposal excludes the long-term portion of incentive compensation, non-corporate incentive plan costs, and incentive compensation that exceeds 25 percent of individual's base salary. Moreover, it includes only 70 percent of the targeted incentive compensation level.[159]

161. Xcel's proposal and calculation is based upon on the same rationale that was allowed by the Commission in Xcel's most recent gas rate case.[160]

162. Because the incentive compensation proposal is consistent with the Commission's Order in Xcel's most recent gas rate case, it is reasonable for the Commission to allow recovery in rates of $927,885 of Xcel's incentive compensation in the test-year revenue requirement.[161]

G. Removal of Costs of Corporate Aviation

163. Xcel initially proposed to recover $164,801 of corporate aircraft expenses included in the test year. Later, Xcel agreed to remove its corporate aircraft expenses from the test year.[162]

164. It is reasonable to remove $164,801 in corporate aircraft expenses from the test year.[163]

H. Increase in Limited Firm Revenue.

165. Natural gas customers who purchase regular sales or transportation service at rates which permit these services to be interrupted are permitted to separately contract for a specified number of days of firm service. These services are contracted through a Limited Firm Service Agreement. The revenues received from such contract are denoted as "limited firm revenues."[164]

166. Xcel's limited firm revenues include both an availability charge and a commodity charge. For the availability charge, Xcel multiplied an estimated 60

[158] OES Ex. 75 at 6 (La Plante Direct).

[159] *Id.,* at 7 (La Plante Direct).

[160] OES Ex. 75 at 6-7 (La Plante Direct); *see also,* Order, *In the Matter of the Application of Northern States Power Company, a Minnesota Corporation and Wholly Owned Subsidiary of Xcel Energy Inc., for Authority to Increase Rates for Natural Gas Service in Minnesota*, MPUC Docket No. E002/GR-06-1429 at 12-13 (September 10, 2007).

[161] OES Ex. 75 at 6-7 (La Plante Direct).

[162] Xcel Ex. 14 at 17-18 (Heuer Rebuttal); OES Ex. 83 at 39 (Johnson Direct); OES Ex. 84 at MAJ-7, Column (f) and MAJ-32 (Johnson Direct Attachments).

[163] *Id*.

[164] OES Ex. 83 at 33-34 (Johnson Direct).

customers by an average rate of $5,167.75 per customer to arrive at $310,065. For the commodity charge, Xcel multiplied an estimated 1.3 million gallons of propane by an average price of $1.0984615 per gallon to arrive at $1,428,000. Xcel then multiplied the sum of these charges by its Minnesota jurisdictional allocator of 96.767 percent to determine the test-year amount of $1,681,873.[165]

167. Arguing that Xcel should have calculated the average price or revenue per customer by using historical information, dividing those revenues by the past numbers of customers, and then multiplying the revenue per customer by the expected number of customers, OES asserted that the Applicant's revenue calculations were understated. OES recommended that the average price per customer be based upon the average availability charges divided by the average number of customers over the same time period, resulting in a test-year average price per customer of $5,961.54. Further, OES recommended that the number of customers in the test year be updated to reflect the actual number of customers in the program. With these adjustment the test-year availability charge revenue increased by $59,550.[166]

168. OES also argued that two variables in the limited firm revenue calculation – namely, the "number of curtailment days" and the "percentage of propane used" – should likewise be based upon historical averages. Between the years 2003 and 2008, on average, there were 11 curtailment days. The average percentage of propane gas used between the years 2003 and 2008 was 43 percent. Accordingly, OES urged increasing test-year commodity charges by an additional $222,196.[167]

169. For its part, Xcel agreed that the adjustments to the test-year limited firm revenues for the Minnesota jurisdiction were reasonable – and that this number should be increased by $272,637.[168]

170. Xcel also urged its own revision to the calculation on the expense side of its ledger – proposing an increase in test-year purchased gas expense of $215,000 to recognize additional commodity costs – a matter as to which OES agreed.[169]

171. It is reasonable to increase the Applicant's test-year limited firm revenues for the Minnesota jurisdiction by $272,637 and it's purchased gas expense by $215,000.[170]

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[165] OES Ex. 83 at 33 (Johnson Direct).

[166] OES Ex. 83 at 36 (Johnson Direct); OES Ex. 84 at MAJ-30, Column (h) (Johnson Direct Attachments).

[167] OES Ex. 83 at 37-38 (Johnson Direct) and OES Ex. 84 at MAJ-30, Column (g) (Johnson Direct Attachments).

[168] OES Ex. 83 at 38 (Johnson Direct); Xcel Ex. 14 at 21 (Heuer Rebuttal).

[169] Xcel Ex. 14 at 21 (Heuer Rebuttal); OES Ex. 86 at 22 (Johnson Surrebuttal).

[170] *Id*.

I. Increase in Late Payment Revenue.

172. Xcel proposed to include $1,389,625 as test year revenue from late payment charges to customers whose bills are delinquent. Increased late payment revenue prompts a corresponding reduction in the amount of the revenue requirement.[171]

173. Xcel's proposed test-year amount was based on four months of data (January through April 2009) that is annualized over the test year, along with the forecasted percentage of change in commodity revenues.[172]

174. OES asserted that the historical averages of such revenue indicated that a higher amount of revenue should be included in the test year. For the period 2006 through 2009 late payment revenue ranged between .27 percent and .32 percent of company sales revenue – equaling a four-year average of .28 percent. Applying a four-year average of .28 percent to Xcel's sales, OES urged an increase of $181,497 in Xcel's late payment revenue.[173]

175. Xcel offered to adjust its late payment revenue calculation provided that it would be permitted to update its retail revenue due to changes in the sales forecast and use a three-year average (the years 2007 through 2009) in the calculation. OES agreed.[174]

176. Because Xcel's rebuttal sales forecast is reasonable, it is likewise reasonable to increase in Xcel's test-year late payment revenue by $104,000.[175]

J. Reduction to Administrative and General Expense Related to Service Company Allocations.

177. Northern States Power Company, a Minnesota Corporation (NSPM), is a wholly-owned subsidiary of Xcel Energy, a registered holding company under the Public Utility Holding Company Act of 2005. NSPM is a multi-utility, multi-jurisdictional company that provides electric and natural gas service. NSPM's electric operations provide service to customers in Minnesota, North Dakota, and South Dakota. NSPM's gas operations (NSPM Gas) provide natural gas service to customers in North Dakota and Minnesota.[176]

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[171] OES Ex. 75 at 15 (La Plante Direct).

[172] OES Ex. 75 at 15 and LL-12 (La Plante Direct).

[173] OES Ex. 75 at 15-16, LL-11 and LL-12 (La Plante Direct).

[174] Xcel Ex. 14 at 23 (Heuer Rebuttal); OES Ex. 76 at 9 (La Plante Surrebuttal).

[175] *See,* OES Ex. 76 at 9 (La Plante Surrebuttal); Xcel Ex. 14 at 23 (Heuer Rebuttal); Hearing Transcript, Vol. 2 at 101-102 (Shah).

[176] OES Ex. 83 at 3-4 (Johnson Direct).

178. Xcel Energy owns Xcel Energy Services, Inc. (XES or the Service Company). XES provides shared or common administrative and management services and some technical services to Xcel Energy and its subsidiaries, including NSPM. Costs are then assigned or allocated to NSPM's gas operations and the Minnesota jurisdiction.[177]

179. In this proceeding, and others, OES has expressed concerns regarding Xcel's cost allocation methods and the share of expenses allocated to "the Minnesota jurisdiction." Specifically, in this matter, it urged a $36,512 reduction in the administrative and general expense related to service company allocations.[178]

180. Xcel accepted OES's cost allocation reduction of $36,512 and likewise agreed to report specific allocation statistics on an annual basis, beginning with the May 1, 2011 Minnesota Jurisdictional Reports. However, it asserted that "issues related to the general allocator should be resolved in [a parallel] affiliated-interest proceeding…."[179]

K. Pension.

181. Xcel currently uses an "actuarial funding method" to recover pension costs. The actuarial funding method "determines the discounted cost of the future benefit obligations, compares that cost to the existing funds and expected long-term returns on investments dedicated to funding these obligations, and then determines the amount needed to cover any shortfall."[180]

182. Using this method, Xcel has made no payment into the pension plan since 1994. As a result, "the revenue requirement for pension expense has consistently been zero, and zero prepaid pension assets have been included in rate base."[181]

183. Beginning January 1, 2011, Xcel expects pension expenses to increase significantly from current levels. Xcel asserts that the financial downturn in 2008 "significantly affected the funded status of the pension plan, creating a significant fund deficiency." Additionally, the new Pension Protection Act sharply reduces the time frame within which Xcel can "return the fund to at least minimum funding levels" and thereby "creates new and significant volatility."[182]

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[177] OES Ex. 83 at 4 (Johnson Direct).

[178] OES Ex. 79 at 5-17 (St. Pierre Direct).

[179] Xcel Ex. 29 at 2-3 and 10 (Locker Rebuttal).

[180] Xcel Ex. 24 at 4 (Moeller Direct).

[181] *Id.*

[182] OES Ex. 83 at 42 (Johnson Direct); Xcel Ex. 24 at 4 (Moeller Direct).

184. Xcel proposed to address the pension shortfall by recovering $3,456,000 beginning January 1, 2011. This element of the revenue requirement is based upon a four-year amortization of a shortfall that Xcel expects to occur in the future. Xcel proposed to use an average of four years of estimated pension costs, for the period 2011-2014. It also proposed a tracker and carrying charge on any over-recovery or under-recovery, with the tracker balance to be offered as an adjustment to pension expense in a subsequent rate case.[183]

185. At the evidentiary hearing, Xcel withdrew its pension request following an agreement with the OAG.[184]

L. Gas Delivery O&M All Categories.

186. Xcel included $68.3 million in O&M expenses in the test year. This amount is approximately $10.2 million, or 17.5 percent, higher than the amount included in Xcel's 2007 test year in its last rate case.[185]

187. Likewise, Xcel's proposal would increase such costs from a budgeted amount of $29,352,963 in 2009 to $34,012,996 in the test year. This increase represented $4,660,033, or a 16 percent increase from the level budgeted for 2009.[186]

188. OES objected to Xcel's proposed O&M costs for gas delivery as being significantly higher than recent data from previous years. Specifically, OES objected to the proposed amounts for:

- Materials expense,
- Damage prevention (contract outside vendors),
- Contract outside vendors,
- Miscellaneous expense, and
- Labor expense.[187]

1. Materials Expense.

189. Xcel originally proposed to increase materials expense from a 2009 budget amount of $3,806,096 to $4,509,137 in the test year, which represents a $703,041 or 18 percent increase compared to the 2009 budget.[188]

[183] Xcel Ex. 13 at 75-76 (Heuer Direct) and OES Ex. 83 at 42-43 (Johnson Direct).

[184] Xcel Ex. 46 (Moeller Evidentiary Statement) and Tr. Vol. 1 at 102 (Mark Moeller); Tr. Vol. 2 at 121 (Mark Johnson).

[185] Xcel Ex. 13 at 47 (Heuer Direct); OES Ex. 83 at 6 (Johnson Direct).

[186] OES Ex. 83 at 8 (Johnson Direct).

[187] OES Ex. 83 at 8 – 31 (Johnson Direct).

[188] *Id.* at 11 (Johnson Direct).

190. Based upon Xcel's 2009 budgeted materials expense plus $353,041 in incremental maintenance expense in the test year, OES recommended that the Commission allow Xcel to recover a test-year amount of materials expense of $4,156,096.[189]

191. The OAG argues that the Company should track the locating services it performs for gas customers, for electric customers and for customers who receive both types of utility services. It is not clear, how, if at all, this segmentation would contribute to precision in the amount of the projected materials expense.[190]

192. During the evidentiary hearings, Xcel agreed to the OES's position "for the purposes of this case."[191]

193. It is reasonable to allow Xcel to recover test-year O&M materials expense of $4,156,096.[192]

2. Damage Prevention.

194. Under Minnesota's One-Call Statute, Xcel is required to identify and mark their underground facilities within 48 hours of the submission of a request to Xcel. Xcel generally contracts with outside vendors to complete this "facility locating" work. Accordingly, the terms "Damage Prevention (contract outside vendors) expense" refers to Xcel's costs for damage prevention work that is performed by outside vendors. Xcel also uses the terms, "Damage Prevention (other)" to describe this expense.[193]

195. Xcel proposed to increase damage prevention (contract outside vendors) expenses from a budgeted amount of $1,586,384 in 2009 to $2,261,032 in the test year. This amount represents a $674,648 or 43 percent increase over the 2009 budget.[194]

196. In response to OES discovery, Xcel identified budgeting errors and, as a result, reduced the test-year damage prevention (contract outside vendors) expense by $678,717, from $2,261,032 to $1,582,315.[195]

197. For the category "damage prevention (other)," OES likewise argued that the test-year O&M distribution expense should be reduced by $442,698 ($359,692 +

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[189] OES Ex. 83 at 17 (Johnson Direct).

[190] *Compare,* Ex. 49 at 24-25 (Smith Surrebuttal).

[191] Xcel Ex. 43 at 1 (Kaphing hearing statement); Tr. Vol. 1 at 14 (Poferl) and 81 (Kaphing).

[192] Tr. Vol. 2 at 121 (Johnson).

[193] OES Ex. 83 at 18 (Johnson Direct).

[194] *Id*.

[195] OES Ex. 83 at 20 (Johnson Direct) and OES Ex. 84 at MAJ-21 (Johnson Direct Attachments).

$83,006) to account for the labor and miscellaneous expense portions of Xcel's proposed adjustment.[196]

198. Xcel accepted the recommendation of OES.[197]

199. As a result, the Commission should reduce test-year O&M distribution expense by $678,717, relating to "damage prevention (contract outside vendors)" and by an additional $442,698 relating to "damage prevention (other)."[198]

3. Contract Outside Vendors.

200. "Contract outside vendors' expense" refers to costs incurred by outside contractors to perform utility work, with the exception of damage prevention work, on behalf of Xcel.[199]

201. Xcel proposed to increase the expense for contract outside vendors' expense from a budgeted amount of $1,499,384 in 2009 to $4,555,962 in the test-year, an increase of $3,056,285 or 204 percent over the 2009 budget.[200]

202. While acknowledging that Xcel's expense for contract outside vendors has been increasing over time, at a rate higher than inflation, OES objected to the proposed inclusions in the test year expenses. Instead, OES recommended that Xcel be allowed to recover a test-year amount based on Xcel's budgeted 2009 expense for contract outside vendors plus 9.73 percent. This proposal resulted in a revenue requirement of $1,645,596 and reduced Xcel's proposed test-year expense for contract outside vendors by $2,910,366.[201]

203. The OAG urges the Commission to cap the recovery in the test year to the amount of the 2009 budget for these expenses.[202]

204. During the evidentiary hearings, Xcel agreed to the OES's position "for the purposes of this case," and it is reasonable to allow test-year O&M contract outside vendors' expense of $4,156,096.[203]

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[196] OES Ex. 83 at 21 (Johnson Direct) and OES Ex. 84 at MAJ-7, Column (u), (Johnson Direct Attachments).

[197] Xcel Ex. 14 at 17 (Heuer Rebuttal).

[198] OES Ex. 86 at 9 (Johnson Surrebuttal).

[199] OES Ex. 83 at 22 (Johnson Direct).

[200] OES Ex. 83 at 22 (Johnson Direct).

[201] OES Ex. 83 at 27 (Johnson Direct).

[202] OAG Initial Brief, at 16-17.

[203] Xcel Ex. 43 at 1 (Kaphing hearing statement); Tr. Vol. 1 at 14 (Poferl) and at 81 (Kaphing); Tr. Vol. 2 at 121 (Johnson).

4. Miscellaneous Expense.

205. Xcel initially proposed to increase miscellaneous expense from a budgeted amount of $3,594,111 in 2009 to $4,484,320 in the test year, which represented an $890,209 or 25 percent year-over-year increase.[204]

206. The test-year increase in miscellaneous expense is attributable to a reduction in forecasted meter-set credits. For every meter-set credit there is an equivalent reduction in the labor budget associated with the labor to install new business meters.[205]

207. Xcel's proposed increase in test-year miscellaneous expense is reasonable.[206]

5. Labor Expense.

208. Xcel proposed to decrease labor expense from a budgeted amount of $18,866,695 in 2009 to $18,202,545 in the test year, for a $664,150 or 4 percent year-over-year decrease.[207]

209. Xcel's forecasted reduction in gas meter purchases (and corresponding meter-set credits) accounts for Xcel's proposed decrease in test-year O&M labor expense. The 2010 test year labor budget of $18,202,545 represents a levelized annual increase of 2.7 percent compared to the previous test year budget (2007) of $16.8 million. This level is consistent with known annual labor merit increases for Xcel's bargaining employees over the same period.[208]

210. Xcel's proposed reduction in labor expense is reasonable.[209]

6. Xcel's Budgeting.

211. Xcel agreed to take steps to improve cost documentation methods in advance of future rate cases.[210]

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[204] OES Ex. 83 at 28 (Johnson Direct). Xcel reduced that amount by $83,006. OES Ex. 83 at 29 (Johnson Direct).

[205] OES Ex. 83 at 30 (Johnson Direct).

[206] *Id.,* at 29 - 30 (Johnson Direct).

[207] OES Ex. 83 at 30 (Johnson Direct) Xcel Ex. 33 at SSH-2, Schedule 1 (Hults Trade-Secret Rebuttal),

[208] *Id.*

[209] *Id*.

[210] Tr. Vol. 1 at 14 (Poferl).

N. Test-year revenue requirements to reflect the Commission's final Order regarding Xcel's remaining lives study (Docket No. G,E002/D-10-173).

212. This issue is discussed under heading "W. Depreciation expense."[211]

O. Adjustments Related to Uncollected Contributions in Aid of Construction (CIAC) and Payment of Over-Collected CIAC to the HeatShare Program.

213. Xcel's proposed a rate base reduction of $55,157 to account for contributions in aid of construction (CIAC) it obtained from customers and offsets to the revenue requirement. It likewise proposes to transfer $33,019 to the HeatShare program as an offset for CIAC over-collection during the years 2006 through 2008.[212]

214. The OES agrees the proposed reduction and transfer are reasonable.[213]

215. It is reasonable for the Commission to reduce rate base by the $55,157 proposed by Xcel and to authorize the transfer of $33,019 to the HeatShare program.[214]

O. Marketing, Economic Development, Gas Sales and Advertising Expense.

1. Marketing.

216. Xcel proposed to recover a total of $1,652,406 in marketing and sales expenses.[215]

a. Marketing Organization.

217. Xcel proposed to recover $647,811 in marketing organization expenses.[216]

218. Xcel's Marketing Organization's expenses relate to providing customer service and information and avoid both the potential for "load building" and double-recovery in the rate base.[217]

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[211] *See, infra*.

[212] Xcel Ex. 14 at 11-13 (Heuer Rebuttal); OES Ex. 70 at 23-24, 25-26 (Minder Surrebuttal); Xcel Ex. 32 at 6-7 (Hults Rebuttal).

[213] OES Ex. 70 at 23 and 25 - 26 (Minder Surrebuttal).

[214] *Id*.

[215] OES Ex. 65 at 22 (Minder Direct).

[216] Xcel Ex. 34 at 3 (Woolf Rebuttal); OES Ex. 70 at 31 (Minder Surrebuttal).

[217] OES Ex. 65 at 27 (Minder Direct); OES Ex. 70 at 8-9 (Minder Surrebuttal); OES Ex. 72 at BJM-S-2 (Minder Surrebuttal Attachments).

219. It is reasonable for the Commission to allow $647,811 in expenses associated with the Marketing Organization.[218]

b. Gas Business Development.

220. Xcel proposed to recover $979,343 in gas business development expenses.[219]

221. OES agreed that Xcel's Gas Business Development area provided more value to ratepayers than it cost and that Xcel had used reasonable methods for determining the dominant fuel type of equipment chosen by builders, developers and customers.[220]

222. It is reasonable for the Commission to allow $979,343 in expenses associated with the Gas Business Development area.[221]

c. Other Expenses in Sales FERC Accounts.

223. Xcel proposed to recover $25,252 in expenses relating to "sales FERC accounts."[222]

224. These expenses entail legitimate Company activities such as corporate informational meetings; training on safety methods; FERC compliance; corporate policies; and setting annual performance goals and periodic performance reviews.[223]

225. It is reasonable for the Commission to allow $25,252 in other expenses in "sales FERC accounts."[224]

2. Economic Development.

226. Xcel proposed to recover $34,855 in economic development expenses during the test year.[225]

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[218] Xcel Ex. 34 at 5 (Woolf Rebuttal); OES Ex. 70 at 31 (Minder Surrebuttal).

[219] Xcel Ex. 34 at 12 (Woolf Rebuttal); OES Ex. 70 at 31 (Minder Surrebuttal).

[220] OES Ex. 70 at 11 and 14 (Minder Surrebuttal); OES Ex. 71 at BJM-S-1 (Minder Surrebuttal Attachments).

[221] OES Ex. 70 at 14 (Minder Surrebuttal).

[222] Xcel Ex. 34 at 12 (Woolf Rebuttal); OES Ex. 70 at 31 (Minder Surrebuttal).

[223] Xcel Ex. 34 at 8 (Woolf Rebuttal); OES Ex. 65 at 29 (Minder Direct); OES Ex. 70 at 15 (Minder Surrebuttal).

[224] OES Ex. 70 at 15 (Minder Surrebuttal).

227. Xcel's proposed test-year economic development expenses provide more value to ratepayers – through the addition of new commercial and industrial customers to its roster of ratepayers – than those activities cost.[226]

228. It is reasonable for the Commission to allow $34,855 in economic development expenses during the test year.[227]

3. Advertising.

229. Xcel requested recovery of $555,283 for costs relating to advertising in the test year. Of this sum it, proposes to recover $235,654 in expenses related to "Customer Programs and Communications;" $7,291 in expenses for "General Advertising;" and $312,338 in expenses relating to "Safety Advertising."[228]

230. Xcel's proposed test-year expenses, and accounting methods, for Customer Programs and Communications, General Advertising and for Safety Advertising are consistent with the requirements of Minn. Stat. § 216B.15, subd. 8 (b). Specifically, Xcel's practice of segregating CIP-related advertising expenses in the gas CIP tracker account, make the recovery of the proposed expenses in this docket appropriate.[229]

231. It is reasonable for the Commission to allow Xcel to recover the entire $647,811 in advertising expenses.[230]

P. HomeSmart.

232. HomeSmart's other charges were subtracted by Xcel from the regulated costs that are at issue in this proceeding. Accurate determination of these costs, and the size of the corresponding deduction, assures that ratepayers do not subsidize Xcel Energy's non-regulated, appliance repair business.[231]

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[225] Xcel originally proposed to recover $34,457 in expenses, but $397 for labor-related costs which should have been included. Ex. 70 at 16 (Minder Surrebuttal). *See also,* OES Ex. 65 at 30 (Minder Direct) and OES Ex. 66 at BJM-5 (Minder Direct Attachments).

[226] OES Ex. 65 at 31-33 (Minder Direct) and OES Ex. 66 at BJM-5 (Minder Direct Attachments).

[227] OES Ex. 70 at 16-17 (Minder Surrebuttal) and OES Ex. 72 at BJM-S-3 (Minder Surrebuttal Attachments).

[228] OES Ex. 65 at 34 (Minder Direct) and OES Ex. 66 at BJM-7 (Minder Direct Attachments).

[229] Xcel Ex. 34 at 11 (Woolf Rebuttal); OES Ex. 65 at 35-36 (Minder Direct); OES Ex. 70 at 18 (Minder Surrebuttal).

[230] OES Ex. 70 at 18 (Minder Surrebuttal).

[231] *See generally,* Ex. 79 at 20-21 (St. Pierre Direct).

233. Because of uncertainties its own budget data, Xcel has agreed that the Commission should:

> (1) deny test-year Administrative and General Expense in the income statement of $9,403 for HomeSmart's Other Charges, and,
>
> (2) deny $18,941 of Customer Service Expense in the income statement.[232]

234. It is reasonable for the Commission to exclude $9,403 of HomeSmart's Other Charges and $18,941 of Customer Service Expense from the test year expenses.[233]

Q. Sales Forecast – Customer Count and Sales Volume

235. Xcel proposed that the Commission should set the average customer-count at 434,699.[234]

236. OES urges the Commission to set the energy sales volume at 89,643,394 Dth – a figure that is 73,599 Dth (0.08 percent) higher than Xcel's forecast of 89,569,795 Dth.[235]

237. Consistent with this recommendation, Xcel's cost of gas should be increased by approximately $445,685 and its operating revenue should be increased by approximately $564,988.[236]

238. During these proceedings, Xcel updated its forecast based on actual data, but did not update the underlying model by incorporating the actual data.[237]

239. The OES later concluded that any difference between Xcel's rebuttal sales forecast and the results using updated models was *de minimus* and did not merit an update to Xcel's rebuttal sales forecast.[238]

240. The Xcel customer count and the OES-recommended sales volumes are reasonable.[239]

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[232] OES Ex. 14 at 18-19 (Heuer Rebuttal); OES Ex. 82 at 6, 22-23 (St. Pierre Surrebuttal).

[233] *Id*.

[234] OES Ex. 73 at 20 (Shah Direct) and Xcel Ex. 18 at JEM-1, Schedule 3, page 2 (Marks Direct).

[235] OES Ex. 73 at 21 (Shah Direct).

[236] OES Ex. 73 at 21 (Shah Direct).

[237] OES Ex. 74 at 6 (Shah Surrebuttal).

[238] Tr. Vol. 2 at 101-102 (Shah).

[239] OES Ex. 73 at 20 and SS-11 (Shah Direct).

R. Pre-Filing of Sales Forecast Data.

241. Section 3.3.13 of the Settlement document in Xcel's 2004 gas rate case (MPUC Docket No. G002/GR-04-1511) obliges Xcel to annually submit to the Commission to a New Large Customer Report.[240]

242. More recently, in Xcel's last electric rate case (MPUC Docket No. E002/GR-05-1428), the Commission required that "at least 30 days in advance of the date of its next gas or electric general rate case filing, Xcel shall make a filing providing the data used in its test year sales forecasts …."[241]

243. Xcel has complied with both Commission requirements. Moreover, Xcel confirms that it will continue the practice of pre-filing forecast information in advance of future rate cases and continue to work with OES to refine its forecasting methods.[242]

244. Under these circumstances, it is reasonable for the Commission to discontinue the requirement to annually submit to the Commission to a New Large Customer Report.[243]

S. Conservation Improvement Program (CIP).

245. A utility filing a general rate case must either have an approved conservation improvement plan on file with the OES or include in its general rate case notice an energy conservation plan.[244]

246. Xcel's CIP plan was approved by the OES in MPUC Docket Nos. E,G002/CIP-09-198 and E,G002/CIP-09-198.01.[245]

247. It is reasonable for the Commission to accept Xcel's plan as being in compliance with Minn. Stat. § 216B.16, subd 1.[246]

248. Xcel has a tracker account to track CIP expenditures and revenues between general rate cases as well as the revenues from the Conservation Cost Recovery Charges (CCRC).[247]

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[240] OES Ex. 73 at 11-13 (Shah Direct).

[241] *Id.* at 5-9 (Shah Direct).

[242] *Id.* at 6-9 (Shah Direct); Xcel Ex. 19 at 1 and 4 (Marks Rebuttal).

[243] OES Ex. 73 at 11-13 (Shah Direct).

[244] *See,* Minn. Stat. §§ 216B.16, subd. 1 and 216B.241 (2009); OES Ex. 65 at 2 (Minder Direct).

[245] OES Ex. 65 at 2-3 (Minder Direct).

[246] *See, id*.

[247] OES Ex. 65 at 3 (Minder Direct); *see generally,* MPUC Docket Nos. G002/GR-86-160 and G002/M-86-165.

249. The CCRC has been calculated by dividing test-year CIP expenses by the test-year Mcf sales approved by the Commission. During a subsequent general rate case, Xcel will either recover from, or returns to, ratepayers the difference between CIP costs incurred by Xcel and revenues derived by Xcel from the CCRC.[248]

250. In Xcel's most recent gas rate case, the Commission approved a CCRC of $0.00524 per therm. In that case, the Commission did not require Xcel to zero out its CIP tracker account balance.[249]

251. In this rate case, Xcel does not propose to zero out its true-up account or to change its CIP Adjustment Factor. The balance of Xcel Gas' tracker account as of December 31, 2009 was $5,233,468.[250]

252. Xcel did not seek recovery of the unamortized balance in the CIP tracker account in its base rates. Instead, the cost is reflected in a CIP Adjustment Factor Rider.[251]

253. Xcel asserts that it will address any changes to the CIP Adjustment Factor in future annual CIP tracker cost recovery dockets.[252]

254. Xcel proposed to include $3,616,989 of CIP expenses in the test year. This expense level is determined by Xcel's proposal to maintain the currently approved CCRC of $0.00524 per therm.[253]

255. Because the OES recommended an adjustment to Xcel's sales, it also urged a corresponding increase in the level of CIP expenses and revenues in the test year by $4,218 (from $3,616,989 to $3,621,208).[254]

256. Following the submission of updated sales figures, Xcel proposed that CIP expenses and revenues in the test year be increased still further – from $3,616,989 to $3,636,654.[255]

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[248] OES Ex. 65 at 3-4 (Minder Direct).

[249] OES Ex. 65 at 4 (Minder Direct); (Docket No. G002/GR-06-1429).

[250] OES Ex. 65 at 7 (Minder Direct) and OES Ex. 66 at BJM-2 (Minder Direct Attachments).

[251] OES Ex. 65 at 7 (Minder Direct).

[252] Xcel Ex. 13 at 69 (Heuer Direct).

[253] Xcel Ex. 37 at AAL-1, Schedule 2 (Liberkowski Direct); OES Ex. 65 at 9 (Minder Direct).

[254] OES Ex. 65 at 13-17 (Minder Direct).

[255] Xcel Ex. 38 at 3 and AAL-2, Schedule 1, page 1 of 5 (Liberkowski Rebuttal) and OES Ex. 70 at 3 (Minder Surrebuttal).

257. OES agreed that it is reasonable to upwardly adjust CIP expenses to this level so long as the amount of sales changes and the CCRC is maintained, based upon the final level of sales approved by the Commission in this matter.[256]

258. It is reasonable for the Commission to:

(a) maintain the relationship link between Xcel's CCRC, sales and expenses, through the rates it adopts in this matter;

(b) approve Xcel's proposal to allocate CIP expenses by dividing the Commission-approved test-year CIP expenses by the Commission approved test-year sales, excluding the test-year sales volumes for customers who have been granted CIP exemptions;

(c) require Xcel to account for, on a monthly basis, any CIP costs that are not recovered from non-CIP exempt flexible rate customers due to rate discounting, and to provide this information in Xcel's annual miscellaneous CIP Adjustment Factor and Demand Side Management (DSM) filings; and,

(d) approve CIP expenses and revenues in the test year of $3,636,654.[257]

T. Class Revenue Allocation.

1. Rate-Design Principles.

259. In Minn. Stat. § 216B.03, the Minnesota Legislature set forth key principles for rate design. Those key principles include:

(a) "Every rate made, demanded, or received by any public utility … shall be just and reasonable."

(b) "Rates shall not be unreasonably preferential, unreasonably prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to a class of consumers."

(c) "To the maximum reasonable extent, the commission shall set rates to encourage energy conservation and renewable energy use and to further the goals of sections 216B.164, 216B.241, and 216C.05."

[256] OES Ex. 70 at 4 (Minder Surrebuttal); *compare generally,* OES Ex. 67 at 10.

[257] Xcel Ex. 38 at 3 and AAL-2, Schedule 1, page 1 of 5 (Liberkowski Rebuttal); OES Ex. 65 at 9 and 13-17 (Minder Direct); OES Ex. 70 at 3 (Minder Surrebuttal).

(d) "Any doubt as to reasonableness should be resolved in favor of the consumer."[258]

260. In Minnesota, the purpose of rate design is to determine which customer classes should pay for the costs reflected in the revenue deficiency and what kinds of rates should be used to recover those costs from customers.[259]

261. Likewise important, Xcel provides firm and interruptible "transportation-only" service in Minnesota. Thus, regardless of where customers obtain their natural gas supplies – whether from Xcel or another vendor – all customers within Xcel's service area must pay Xcel to transport that gas through its distribution system.[260]

262. Accordingly, rates for these services must include, at a minimum, the incremental cost of transporting natural gas through the distribution system, along with providing metering, billing and other related customer services.[261]

263. Under a well-designed set of rates, Xcel would be indifferent as to whether its customers purchased transportation and natural gas services from Xcel or merely transportation services. Under such a design, natural gas customers would freely choose between Xcel and other third-party suppliers based upon the relative costs of purchasing gas from these companies.[262]

2. Revenue Apportionment.

264. Xcel's basic service classes include five classes of firm sales customers and three classes of interruptible (non-firm) sales customers.

(a) The classes of firm sales customers are:

1. Residential;
2. Small Commercial Firm Service (SCFS);
3. Large Commercial Firm Service (LCFS);

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[258] Minn. Stat. § 216B.03; *compare also,* Minn. Stat. § 216B.07 ("No public utility shall, as to rates or service, make or grant any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage"); *In re Northern States Power Co.,* 416 N.W.2d 719, 722-23 (Minn. 1987) ("[B]y merely showing that it has incurred, or may hypothetically incur, expenses, the utility does not necessarily meet its burden of demonstrating it is just and reasonable that the ratepayers bear the costs of those expenses").

[259] *See, Matter of Request of Interstate Power Co. for Authority to Change Rates*, 559 N.W.2d 130, 133 (Minn. App. 1997), *aff'd* 574 N.W.2d 408 (Minn. 1998).

[260] OES Ex. 63 at 8-9 (Shaw Direct).

[261] *Id.,* at 9-10 (Shaw Direct).

[262] *Id.,* at 10 (Shaw Direct).

4. Small Commercial Demand Billed Service (SCDB), and

5. Large Commercial Demand Billed Service (LCDB).

(b) The classes of interruptible (non-firm) sales customers are:

1. Small Volume Interruptible Service (SVI), which is available to commercial and industrial customers whose maximum daily requirements are less than 2,000 therms;

2. Medium Volume Interruptible Service (MVI), which is available to commercial and industrial customers whose peak day requirements of at least 2,000 therms but less than 50,000 therms; and,

3. Large Volume Interruptible Service (LVI), which is available to commercial and industrial customers with peak day requirements in excess of 50,000 therms.[263]

[263] OES Ex. 63 at 7-8 (Shaw Direct).

265. Xcel and the OES agree on the revenue apportionment shown in the Table below:

Summary of NSPM's Proposed Revenue Apportionment[264]

Customer Class	Current Apportionment	NSPM Proposed Apportionment	Cost-Based Apportionment	Percent Increase in Revenue w/out gas costs *	Percent Increase in Revenue w/ gas costs *
Residential	66.77%	68.09%	74.07%	12.63%	3.95%
Small Commercial	10.58%	10.36%	8.84%	8.14%	2.03%
Large Commercial	11.25%	10.59%	7.51%	3.96%	0.81%
Small Commercial Demand Billed	0.13%	0.13%	0.08%	5.91%	1.08%
Large Commercial Demand Billed	2.01%	1.93%	0.91%	5.87%	1.13%
Small Interruptible	2.27%	2.28%	0.94%	10.86%	1.85%
Medium Interruptible	1.99%	2.00%	1.19%	10.91%	0.94%
Large Interruptible	0.76%	0.77%	0.50%	10.95%	0.79%
Firm Transportation	0.24%	0.23%	0.10%	6.06%	6.06%
Interruptible Transportation	0.15%	0.15%	0.08%	11.16%	11.16%
Negotiated Transportation	0.65%	0.59%	0.79%	0.00%	0.00%
Generation – System	0.13%	0.13%	0.08%	11.18%	0.82%
Generation – Transportation	3.05%	2.76%	4.91%	0.00%	0.00%
Total Retail	**100.00%**	**100.00%**	**100.00%**	**10.46%**	**2.79%**

* Note: The percentages in this column do not equal the percentage difference between "Current Apportionment" and "NSPM Proposed Apportionment."

266. Xcel's proposed revenue apportionment address the need for additional revenues, moves customer class closer to the cost of servicing those classes and does so without causing rate shock. Xcel's proposed revenue apportionment is reasonable.[265]

U. Charges for Commercial, Interruptible and Firm Service Customers.

267. For all customer classes other than the residential class, Xcel and OES agreed on the appropriate levels of customer charges.[266]

264 OES Ex. 62 at 3-4 (Ouanes Surrebuttal); OES Ex. 63 at 15 (Shaw Direct).

265 OES Ex. 63 at 16-23 (Shaw Direct).

266 Tr. Vol. 1 at 115-116 (Liberkowski).

268. The agreements between Xcel and the OES are reflected in the Table below:

Summary of OES's Proposed Customer Charges[267]

Customer Class	Customer Cost	Current Customer Charge	OES Proposal	Percentage Increase
Small Commercial	$29.16	$20.30	$25.00	23.15%
Large Commercial	$49.33	$40.00	$50.00	25.00%
Small Commercial Demand Billed	$116.67	$150.00	$150.00	0.00%
Large Commercial Demand Billed	$133.43	$275.00	$275.00	0.00%
Small Interruptible	$142.66	$125.00	$145.00	16.00%
Medium Interruptible	$206.80	$300.00	$300.00	0.00%
Large Interruptible	$243.88	$450.00	$450.00	0.00%
Large Firm Transportation	$132.53	$300.00	$300.00	0.00%
Small Interruptible Transportation	$156.86	$150.00	$170.00	13.33%
Medium Interruptible Transportation	$156.86	$325.00	$325.00	0.00%
Large Interruptible Transportation	$156.86	$475.00	$475.00	0.00%

269. The customer charge increases bring those charges into closer alignment with the costs of serving those customers and reduces the intra-class subsidies within these customer classes.[268]

V. Class Cost of Service Study.

270. The purpose of a class cost of service study (CCOSS) is to identify, as accurately as possible, the responsibility of each customer class the cost incurred by the utility in providing service to that class. A well-designed CCOSS reflects "cost causality": the assignment of costs to those the customers who impose costs upon the utility system.[269]

271. According to the June 1989 Gas Distribution Rate Design Manual of the National Association of Regulatory Utility Commissioners (Gas Manual), there are three steps in performing a CCOSS. First, costs are "functionalized" by grouping them according to their purpose. Second, costs are "classified" based upon how they are incurred. Third, costs are "allocated" among the various customer classes.[270]

[267] OES Ex. 64 at 4 (Shaw Surrebuttal).

[268] OES Ex. 63 at 25-26 (Shaw Direct).

[269] OES Ex. 61 at 3 (Ouanes Direct).

[270] OES Ex. 61 at 3 (Ouanes Direct); *see, generally,* Uniform System of Accounts (http://www.ferc.gov/legal/acct-matts/usofa.asp).

272. Costs are typically functionalized according to FERC's Uniform System of Accounts. These accounts group costs into their various functions – such as production, storage and distribution.[271]

273. The functionalized costs are the classified as "customer," "demand," and "energy" costs according to how they are incurred.[272]

274. "Customer" costs are those operating and capital costs that vary with the number of customers, regardless of the customers' energy consumption. They include the costs of metering, billing, tracking accounts and responding to customers' questions.[273]

275. "Demand" costs are those costs incurred to serve the peak demand on the system (such as the size of the distribution system), and are not affected by the number of customers to be served.[274]

276. "Energy" costs consist of those costs that vary with the quantity of gas consumed.[275]

277. Functionalized and classified costs are usually allocated to customer classes as follows:

A. Customer-related costs are allocated among the customer classes based upon the number of customers and are typically weighted to reflect differences in metering costs among customer classes;

B. Demand-related costs are allocated among the customer classes based upon the demand imposed on the system during specific peak hours; and,

C. Energy-related costs are allocated among the customer classes based upon the energy which the system must supply in order to serve the various customer classes.[276]

278. Xcel filed a proposed embedded cost study, sponsored by Company Witness James P. Gilroy.[277]

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[271] *Id.,* at 4.

[272] *Id*.

[273] *Id*.

[274] *Id*.

[275] *Id*.

[276] *Id*., at 4-5.

[277] Xcel Ex. 35 (Gilroy Direct) and OES Ex. 61 at 5 (Ouanes Direct).

279. Following the receipt of a series of modest recommendations from OES, Xcel filed a revised CCOSS that included the OES's recommended changes.[278]

280. Xcel's revised CCOSS is based upon recent cost data; is consistent with the Gas Manual; reflects "reasonable judgment in allocating costs to the customer classes;" and offers a reasonable basis for Commission decision-making.[279]

W. Depreciation Expense.

281. Xcel's proposed deprecation expense is based upon the depreciation rates last certified by the Commission in MPUC Docket Nos. G,E002/D-09-160 (Production and Storage Plant) and G,E002/D-07-1528 (Transmission, Distribution and General Plant).[280]

282. Xcel agrees that it is appropriate to adjust the claimed depreciation expense to reflect the Commission's Order in Xcel's February 2010 remaining life filing.[281]

283. On June 16, 2010, the Commission issued its Order approving Xcel's proposed annual review of remaining lives for depreciation of electric and gas production facilities for 2010. In that Order, the Commission approved Xcel's proposal. The effect of this decision should reduce Xcel's depreciation expense by $139,200 compared to the amount Xcel filed in its initial proposal. Thus, the OES and Xcel agreed to the following adjustments to Xcel's rate case:

A. exclude $143,000 of depreciation expense;

B. include $58,000 of annual deferred tax;

C. exclude $72,000 of depreciation reserve-Gas production; and

D. include $29,000 of accumulated deferred taxes.

The net effect, including all of the changes to the income statement and rate base is a reduction in Xcel's overall revenue requirement by $139,200 compared to the amount Xcel filed in its initial proposal.[282]

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[278] *Compare,* OES Ex. 61 at 8-15 (Ouanes Direct) with Xcel Ex. 36 at 8, JPG-2, Schedule 1, at 1A/B-10A/B and Schedule 2 at 1-2 (Gilroy Rebuttal).

[279] OES Ex. 61 at 8-15 (Ouanes Direct); OES Ex. 62 at 2-4 (Ouanes Surrebuttal).

[280] Xcel Ex. 13 at 56 (Heuer Direct); OES Ex. 75 at 9 (La Plante Direct); *compare also,* MPUC Docket No. E,G002/D-10-173 (February 17, 2010) (Xcel's annual remaining-life depreciation study and its five-year study).

[281] Xcel Ex. 14 at 7 (Heuer Rebuttal).

[282] OES Ex. 76 at 7-8 (La Plante Surrebuttal).

X. LEGAL EXPENSE.

284. The issues relating to claimed legal expenses are addressed above under Section III J.[283]

Y. DUPLICATE DONATIONS.

285. The issues relating to duplicate donations are addressed above under Section III O.[284]

Z. AGENCY SERVICE AND SALES TO OTHERS – MN LATE PAYMENT REVENUES.

286. "Agency Services" revenues are generated under a tariffed rate and pertain to the transportation of natural gas service on Xcel's distribution system. "Sales to Others-MN LP" are revenues generated from contractual agreements for a fixed demand payment for propane storage.[285]

287. Xcel has one agency supply agreement with a single metropolitan end-user to purchase and transport gas independent of Xcel's sales service function. Subsequent to filing its initial case, Xcel proposed an adjustment to other revenues included in the test year due to an error in the labeling of its agency service and Sales to Others-MN LP.[286]

288. Decreasing the Minnesota jurisdictional share of other revenues by $39,000 in the test year is appropriate and reasonable.[287]

AA. INTEREST SYNCHRONIZATION.

289. Interest synchronization is used to determine the amount of interest expense that should be included in the calculation of income tax. When an adjustment is made to Xcel's weighted cost of debt, test-year rate base or operating income statement, it is necessary to make corresponding interest synchronization adjustments.[288]

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[283] *See, supra,* "Reduction to Administrative and General Expense Related to Service Company Allocations."

[284] *See, supra,* "Marketing, Economic Development, Gas Sales and Advertising Expense."

[285] Xcel Ex. 13 at 74 (Heuer Direct); OES Ex. 83 at 32 (Johnson Direct).

[286] OES Ex. 84 at MAJ-28 (Johnson Direct Attachments); OES Ex. 83 at 32-33 (Johnson Direct).

[287] *Id*.

[288] OES Ex. 83 at 46 (Johnson Direct).

290. In its initial case, Xcel calculated its interest expense deduction for test-year income-tax purposes by multiplying its rate base by the weighted cost of debt – 3.03 percent.[289]

291. As part of its calculation of income taxes, deducted interest and other charges, Xcel determined that interest synchronization in the amount of $42,000 was required.[290]

292. Based upon the record assembled to date, OES urges an upward adjustment in the interest synchronization amount of $68,000.[291]

293. Following the Commission's decisions in this rate case as to weighted cost of debt, test-year rate base and operating income, the Commission should direct that the amount of interest synchronization be recalculated.[292]

BB. CASH WORKING CAPITAL.

294. Xcel applied lead/lag study factors to its test-year operating expenses and determine that it required a cash working capital balance of $3,942,000.[293]

295. OES reviewed Xcel's lead/lag study factors. It did not object to Xcel's selection of factors, but recommended that cash working capital be adjusted so as to reflect OES's earlier recommendations regarding test-year operating expenses and Commission-approved expense levels.[294]

296. An upward adjustment of $83,000 to cash working capital, so as to account for test-year operating expenses, is reasonable.[295]

CC. TARIFFS.

297. Xcel proposed a set of 66 changes to its existing tariff.[296]

298. From within this set, Xcel withdrew its proposed cancelation of the Fixed Monthly Payment Pilot Program.[297]

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[289] *Id.,* at 47 (Johnson Direct).

[290] *Id*.

[291] OES Ex. 88 at 12 (Johnson Evidentiary Schedules).

[292] OES Ex. 83 at 47 (Johnson Direct); *compare generally,* OES Ex. 84 at MAJ-8 (Johnson Direct Attachments).

[293] Xcel Ex. 13 at AEH-1, Schedule 6, page 6 of 6 (Heuer Direct).

[294] OES Ex. 83 at 48 (Johnson Direct); OES Ex. 84 at MAJ-4 (Johnson Direct Attachments).

[295] OES Ex. 88 at 6-7 (Johnson Evidentiary Schedules).

[296] OES Ex. 66 at BJM-9 (Minder Direct Attachments).

[297] *See,* Xcel Ex.38 at 4 (Liberkowski Rebuttal); OES Ex. 70 at 20 (Minder Surrebuttal).

299. The withdrawal is appropriate because, in earlier proceedings, the Commission earlier cancelled this program.[298]

300. As to the remainder, with one exception, OES recommends approval of each of the proposed tariff changes listed in Exhibit 66, Attachment BJM-9.[299]

301. Xcel and OES diverge on Xcel's proposal to eliminate "free footage allowances" for residential customers. Currently, there is a subsidy for residential customers whose level of energy use would not otherwise cover the costs of reaching them through a service extension.[300]

302. While acknowledging that the elimination of such subsidies has merit as a rate-making policy, OES opposes the elimination of extension allowances for low-use residential customers. It expressed concern over the impact such a tariff revision would have upon the ability of low-use customers to obtain natural gas for space heating.[301]

303. In response to OES's concerns, Xcel stated that the best approach would be to work collaboratively with the OES in order to develop the mutually-agreeable tariff language.[302]

304. The Commission should deny without prejudice Xcel's proposed changes to the extension tariff as to the free footage allowances for low-use residential customers. This matter should be addressed in a separate docket at a later time.[303]

DD. REPORTING UNUSUAL CONSTRUCTION CHARGES, WAIVING OF CIAC IN COMPETITIVE SITUATIONS AND JOINT TRENCHING.

305. OES reviewed Xcel's submissions relating to unusual construction charges, the waiver of CIAC in competitive situations and joint trenching practice.[304]

306. OES did not identify any concerns regarding unusual construction charges or the waiver of CIAC in competitive situations. OES did express concern as to the level of errors in applying the joint trenching tariff in 2009, but did not propose particular adjustments to the tariff on this point.[305]

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[298] *See,* MPUC Docket Nos. G002/M-05-393 and G002/CI-07-541.

[299] OES Ex. 70 at 24-25 (Minder Surrebuttal).

[300] OES Ex. 65 at 83-84 (Minder Direct).

[301] *Id.,* at 82-83 (Minder Direct).

[302] Xcel Ex. 32 at 8 (Hults Rebuttal).

[303] OES Ex. 70 at 20 (Minder Surrebuttal).

[304] *See,* OES Ex. 65 at 27-28 and 73-85 (Minder Direct).

[305] *Id*.

307. The Commission should require Xcel to continue to track information relating to unusual construction charges, the waiver of CIAC in competitive situations and joint trenching practice in advance of its next natural gas rate case.[306]

EE. REVENUE APPORTIONMENT METHODOLOGY.

308. In the event that the Commission approves a revenue requirement lower than that which is requested by Xcel, OES initially urged that the approved revenue requirement be apportioned according to the percentages shown in the table "Summary of NSPM's Proposed Revenue Apportionment," above.[307]

309. Xcel expressed the concern that readjusting a lower revenue requirement according to the revenue apportionment percentages in the table "Summary of NSPM's Proposed Revenue Apportionment," could disrupt the expectations of parties under fixed contracts. For example, Negotiated Transportation and Generation Transportation services are provided through contracted rates. Thus, because the revenues from these classes are fixed, Xcel argues that they should be assigned a larger apportionment percentage under a lower revenue requirement. Similarly, Xcel asserted that:

(a) The Distribution Charge for Large Commercial Firm service should be lower than for Small Commercial Firm Service.

(b) The Distribution Charges for Large Interruptible service should be lower than the Distribution Charges for Medium Interruptible service. Likewise, the Distribution Charges for Medium Interruptible service should be lower than the Distribution Charges for Small Interruptible service.

(c) The Demand and Distribution Charges for sales service should be the same as the corresponding transportation service.

(d) The Demand Charges for Small and Large Commercial Demand Billed Service and Large Firm Transportation Service should be identical.

(e) The Distribution Charges for the Small and Large Commercial Demand Billed Service (and Medium Interruptible Service and Large Firm Transportation Service) should be identical. The only rate-design difference should be in the Customer Charges.[308]

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[306] Xcel Ex. 32 at 8-9 (Hults Rebuttal); OES Ex. 65 at 73-85 (Minder Direct); OES Ex. 70 at 28 (Minder Surrebuttal).

[307] OES Ex. 63 at 23-24 (Shaw Direct).

[308] Xcel Ex. 38 at 24-25 (Liberkowski Rebuttal).

310. If the Commission determines that a lower revenue requirement than Xcel's requested $9.924 million is appropriate, the approved revenue requirement should be apportioned according to the percentages shown in The table "Summary of NSPM's Proposed Revenue Apportionment" above, hold revenue from the negotiated transportation and generation transportation classes constant and include the five rate design features referenced in subparagraphs (a) through (e) immediately above.[309]

CONCLUSIONS

1. The Minnesota Public Utilities Commission and the Administrative Law Judge have jurisdiction over the subject matter of this proceeding pursuant to Minnesota Statutes §§ 14.50, 216B.08 and 216B.16.

2. In the absence of competition, government regulation has been used to approximate the results that would be achieved in a competitive environment. Minnesota Statutes §§ 216B.03 and 216B.07 require rates to be reasonable and not unreasonably discriminatory.

3. Applying the 79 percent weight to the LDC ROE of 9.86 percent and a weight of 21 percent to the Combination ROE of 10.95 percent is reasonable. Likewise, the resulting ROE of 10.09 percent for Xcel Gas is reasonable.[310]

4. A reasonable ROR for Xcel, based upon an ROE of 10.09 percent, together with Xcel's proposed cost of for long-term and short-term debt, applied to Xcel's revised capital structure is 8.30 percent.

5. OES recommended adjustments totaling $8,772,000 to Xcel's proposal, resulting in a rate increase of $7,448,000 (to the OES calculated revenues under present rates of $585,580,000). These adjustments are reasonable.[311]

6. OES's recommended Conservation Cost Recovery Charges of $0.00524 per therm, based on its recommended financial position, is also reasonable.[312]

7. A plan for refunding to all customers, with interest, the revenue collected during the Interim Rate period that is in excess of the amount authorized by the Commission is in the public interest.

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[309] OES Ex. 64 at 6-7 (Shaw Surrebuttal); Tr. Vol. 1 at 117 (Liberkowski).

[310] OES Ex. 57 at 7-8 (Griffing Surrebuttal); *compare generally,* Xcel Ex. 10 at 1-2 (Reed Rebuttal).

[311] OES Ex. 88 at 3 and 9 (Johnson Evidentiary Schedules).

[312] *See,* OES Ex. 65 at 4 (Minder Direct).

8. Modifying Xcel's natural gas rates in the manner described in the Findings and Conclusions above results in just and reasonable rates that are in the public interest as those terms are used Minn. Stat. § 216B.11.

RECOMMENDATION

The Administrative Law Judge recommends that the Commission issue an Order providing that:

1. Xcel is entitled to increase gross annual revenues in accordance with the terms of this Report.

2. Within ten days of the service date of this Report, Xcel shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirements for 2010 and the rate design decisions based on the recommendations contained herein.

3. If the Commission orders and Interim Rate Refund within 30 days of the service date of this Order, Xcel shall file with the Commission for its review and approval, and serve upon all parties to this proceeding, a proposed plan for refunding to all customers, with interest, the revenue collected during the Interim Rate period in excess of the amount authorized herein.

4. Xcel shall make further compliance filings regarding rates and charges, rate design decisions, and tariff language as ordered by the Commission.

Dated: October 15, 2010

/s/ Eric L. Lipman
ERIC L. LIPMAN
Administrative Law Judge